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The Political Economy of Vietnam: The Evolution of State-Business Relationships

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Thesis submitted for the degree of PhD in Economics

2015

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Declaration for SOAS PhD thesis

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Abstract

While many Vietnam studies *mention* that state-owned enterprises (SOEs) in Vietnam face soft budget constraints, a limited amount of studies actually focus on this issue. Most of them are based on the analysis of macro level data and few are firm level analyses such as Tenev *et al.* (2003) and Gainsborough (2005) which contain both private firms and SOEs in the data set and compare SOEs with private firms in terms of budget constraints. Despite their insightfulness, details of budget constraints *among* SOEs remain unanswered. To fill this gap, this dissertation analyses the data collected from returned questionnaires from and conducted interviews with 22 local and central SOEs including five equitised SOEs in Hai Phong in 2005. Contrary to the conventional claim, this dissertation finds that the budget constraints on SOEs in Hai Phong have tended to be hardened since the late 1990s and also some large SOEs face *softer* budget constraints than small SOEs do. This dissertation explains these findings in terms of state-business relations. Firstly, the hardened budget constraints on SOEs can be explained by the strategy of the state to reduce the number of SOEs and to form big SOEs, which this dissertation calls *divestiture and concentration*. Secondly, given the importance of Gainsborough's argument that connections of SOE directors with politicians and bankers decide the softness of budget constraints, this dissertation argues that the softer budget constraint on large SOEs is the outcome of the rational choice of the state whose political priority is to keep the dominance of the state sector in the socialist-oriented market economy. By providing financial support to loss-making SOEs, the state will obtain political gain in exchange of financial burdens. Given its budget constraint, the state tends to support large SOEs to maximise its political gain.

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Acronyms

ASN	Amanah Saham Nasional (National Shares Trust of Malaysia)
BBC SWB	British Broadcasting Corporation Summary of World Broadcast
BCT	the Politburo of the Communist Party of Vietnam (<i>Bộ chính trị</i>)
BOD	Board of Directors
CICU	Central Information Collection Unit (of Malaysia)
CP	the Government of Vietnam (<i>Chính phủ</i>)
CPV	Communist Party of Vietnam
FBIS	Foreign Broadcast Information Services Daily Report
FDI	foreign direct investment
GC	General Corporations (<i>Tổng Công ty</i>)
GDP	Gross Domestic Product
GLCs	government-linked companies
GNI	Gross National Income
GNP	Gross National Product
GSO	General Statistics Office of Vietnam
HDBT	the Council of Ministers of Vietnam (<i>Hội đồng Bộ trưởng</i>)
JPRS	Joint Publications Research Services Report
JSBs	joint-stock banks
JSCs	Joint-stock companies
LRT	light rail transits (of Malaysia)
MITI	the Ministry of International Trade and Industry (of Japan)
MNCs	multi-national companies
MOF	Ministry of Finance
NEP	New Economic Policy (of Malaysia)
NIEs	newly industrialising economies
PERNAS	Perbadanan Nasional Berhad (National Corporation of Malaysia)
PNB	Permodalan Nasional Berhad (National Equity Corporation of Malaysia)
POSCO	Pohang Steel Company (of Korea)
RM	Malaysian ringgit
SCIC	state capital investment corporation (of Vietnam)
SEGs	state economic groups (of Vietnam)
SGD	Singaporean dollar
SMEs	small and medium-sized enterprises

SOCBs	state-owned commercial banks
SOEs	state-owned enterprises
TTg	the Prime Minister of Vietnam (<i>Thủ tướng</i>)
TVEs	township village enterprises (of China)
TW	the Central Committee of the Communist Party of Vietnam (<i>Trung ương đảng</i>)
UBND	<i>Ủy ban Nhân dân</i> (People's Committee)
UMNO	United Malays National Organisation
UNDP	United Nations Development Programme
USD	US dollar
VND	Vietnamese dong
WTO	World Trade Organisation

1. Introduction

The state sector in Vietnam has been criticised that it faces soft budget constraints. When stagnating and ineffective state-owned enterprises (SOEs) play the leading role, the state has to pump in even more resources, in some cases to save SOEs that have gone or are on the verge of going bankrupt (Harvard Kennedy School 2013: 7; see also International Monetary Fund 2005, Malesky and Taussig 2009, Matheson 2013, Tenev *et al.* 2003, Tran Huu Huynh *et al.* 2012, World Bank 2008, 2012).¹ The data sets used in those analyses are macroeconomic data showing the credit accessibility of SOEs such as the proportion of capital spent in the state sector, the proportion of loans to SOEs out of total state-owned commercial banks (SOCBs) loans or the proportion of outstanding loans to SOEs. As a result, despite widespread criticism of soft budget constraints of SOEs, we have been lack of understanding of how actually budget constraints work at the firm level.² Furthermore, the implication of soft budget constraints on the behaviour of SOE directors has not been addressed properly.

The soft budget constraints syndrome

Soft budget constraints have become a useful concept for looking at enterprises in socialist countries since János Kornai published his *Economics of Shortage* in 1980. Kornai described stories of economic inefficiency in the Eastern European socialist economies and concluded that the continuous state involvements in bailouts of loss-making SOEs caused investment hunger and shortages in the economy. A shortage

¹ Nguyen Van Thang and Freeman (2009) argue that provinces which have heavier dominance of SOEs are likely to show slower GDP growth and lower GDP per capita and they concluded that favouritism of SOEs has crowded out private businesses. They say that provinces have to choose either a pro-SOEs or a pro-private attitude, but they do not explain why some provinces chose a pro-SOEs attitude and others did not.

² Why is there a lack of studies on budget constraints in Vietnam? Gainsborough (2005: 2) suggests that because “enquiries about the softness or otherwise of the budget constraint quickly leads the researcher into the realm of politics, and firms – understandably – are not always willing to discuss such matters”.

economy also led to an expansion drive and a hoarding tendency which sustained the shortage phenomena and locked the economy in a vicious circle.

Kornai (1980) argues that resource constraints and soft budget constraints are the characteristics of a socialist economy while demand constraints and hard budget constraints are those of a market economy. Only a central government is able to change the economic environment by making the budget constraint harder. Because of this difference, the adjustment mechanism such as a price adjustment and profit incentive mechanism which are ubiquitous in the market economy, fail to apply to the socialist economy (Kornai 1980, 1998).

Easy access to capital can be used as a simple definition of soft budget constraints. However, the *essential* feature of the SBC syndrome, but missed often, is the establishment of SOEs' managers 'expectation' of being bailed out by the state in the case of making a loss. This *ex ante* expectation inspires the managers of SOEs to generate *ex post* expectation of being bailed out, which as a result forms a vicious circle of investment hunger, shortage, loss-making and bailouts in socialist economies (Kornai 1980: 192, 1998, 2001, Kornai *et al.* 2003).

The state is likely to bail loss-making firms out when managers or directors make a loss. Recurrent rescues by the state make directors of state enterprise expect another rescue when they make the next loss, and this expectation shapes a particular pattern of behaviour among SOE directors (Kornai 2001). The belief of SOE directors that the state will bail them out makes them indifferent to losses or profits. Instead, their decisions are guided by other considerations such as satisfying higher level managers or maximising their personal benefits.

Once soft budget constraints are institutionalised, it is very hard to get rid of them because the constraints become incorporated in directors' decision making as they account for the state subsidy before they make their production plans. If the state withdraws the subsidy at a later stage it risks making the enterprise bankrupt. Therefore, hardening budget constraints depends upon a credible announcement by the state that it will not bail out firms in the future and a gradual enforcement of the announcement (Kornai *et al.* 2003).

The viability of the reform depends not only on the political credibility and the will of higher level political leaders but also on the perception of directors of state firms. If directors still have some expectation of bailouts, then it cannot be said that budget constraints are hard, even if the state consistently announces that there will be no bailouts. If no one believes the state announcement and all enterprises continue to behave in a loss-making way, a no-bailout policy will potentially result in widespread bankruptcies, and such a policy is not likely to be credible. Credibility is therefore a collective action problem for the state: it has to make a significant number of enterprises believe in the policy for it to be credible to all enterprises.

The softness of the budget constraints on SOEs can be used as a proxy representing the relations between the state and SOEs (businesses in general). Kornai (1980) suggests that the state wants to bail out loss-making SOEs because of its paternalism.³ The soft budget constraints syndrome involves two parties – a provider and a receiver of financial support – and both are likely to maximise each party's economic and political benefit. The

³ Paternalism is defined as “the system in which a government or an employer protects the people who are governed or employed by providing them with what they need, *but does not give them any responsibility and freedom of choice*” (emphasis added; Oxford Advanced Learner's Dictionary 6th Ed. p. 928). Under the centrally-planned socialist economic system, the definition of paternalism was applicable but this ‘strict’ paternalism is not applicable to socialist countries which experience reform because SOE directors are given responsibilities and freedom of management to a certain extent.

implication that the soft budget constraints syndrome represents the state-business relations is largely ignored in Vietnam studies. Most of them simply point out that SOEs have enjoyed the soft budget constraints without providing detail analysis of the reality of the budget constraints and of the state-business relations. Gainsborough (2005), an important reference to this dissertation, is an exception.

Furthermore, the consideration of state-business relations represented by the softness of budget constraints on SOEs enables us to do comparative analyses. For example, it is widely accepted that it is difficult to distinguish the state sector from the private sector in Vietnam as the border between them is quite murky (see Chapter 2 of this dissertation and Cheshier 2010, Fforde 2007, Gainsborough 2003b among others). This feature is not peculiar to Vietnam only but is also found in Malaysia (Gomez and Jomo 1997, Jomo and Gomez 2000, Tan 2008) and Singapore (Gainsborough 2009b, Hamilton-Hart 2000). SOEs in Vietnam and government-linked companies (GLCs) in Malaysia have been accused of facing soft budget constraints while GLCs in Singapore are often referred to a symbol of efficiency and good governance. Except Gainsborough (2009), it has rarely been addressed why the same factor has led to the inefficient state sector in Vietnam and Malaysia while it has resulted in a significantly different outcome in Singapore (see Chapter 3).⁴

Vietnam studies on budget constraints

During the subsidy period, the situation in Vietnam was not quite different from that in Eastern European socialist economies. The Vietnamese SOEs faced the coexistence of shortages in the market and surpluses in enterprise stocks (Beresford and Fforde 1997, Cheshier 2010, Hiebert 1996). Nonetheless, as we examine in Chapter 2, it is difficult to

⁴ Gainsborough (2009: 1325-6) suggests that the Singaporean state is “more effective in asserting the existence of a clear-cut boundary between state and society, and between public and private, than the state in Vietnam.”

conclude that the Vietnamese SOEs faced soft budget constraints under the central planning system because Vietnam was a country which had a weak tax base and relied heavily on aid. It had considerably large debt compared to other Asian countries such as Indonesia, South Korea, Taiwan and Thailand (Dapice 1993: 170).⁵ Furthermore, Vietnam's economy relied largely upon the aid from the Soviet bloc. For example, the central budget revenues in Vietnam were seriously squeezed when the aid from the Soviet bloc which was roughly equivalent to one billion US dollars was cut off drastically after the dissolution of the Soviet Union in 1991 but a decline in flows had started even earlier (Dollar 1993: 207).

Given that the Vietnam's economy was frequently suffered from a budget deficit even with the help of aid, it is unlikely that SOEs faced soft budget constraints. While SOEs were given a priority in resource allocation but it is another matter whether they had sufficient soft budget constraints like as the SOEs in the Eastern European economies did. The fact that there was nationwide fence-breaking by SOEs in Vietnam under the planning system implies that the budget constraints on SOEs were not soft. The suspension of Soviet aid aggravated the situation. The government had to reduce the support to SOEs while it wanted to collect more tax revenue from SOEs (see Chapter 2; Fforde 2004, 2007).

After major transition to the market mechanism started in 1989, it was expected that the budget constraints on SOE would be hardened. Some argue that the budget constraints on SOEs began to be hardened with the introduction of key reforms since the late 1980s (Beresford 1997, Porter 1993). However, resource allocation began to be concentrated in the state sector which carries the leading role in the economy. The state treated in favour

⁵ Dapice (1993: 170) shows that the size of the budget deficit of Vietnam was ten times larger than that of other countries in his analysis of the statistics of past South Korea, Taiwan, Thailand (as of 1960) and Indonesia (as of 1967) with those of the current Vietnam (as of 1990).

of SOEs and the private sector was relatively ignored. Contrary to a typical argument that economic reform is likely to induce hard budget constraints on SOEs, the reform in Vietnam has made the budget constraints on SOEs rather ‘soft’.⁶ Despite of this conventional perception of soft budget constraints, we do not have many studies on budget constraints which both private firms and SOEs face in Vietnam.

Nonetheless, there are insightful firm-level analyses based on survey researches covering the issue of ‘credit accessibility’ of firms. For example, Tenev *et al.* (2003) examine whether the private firms and SOEs play on a level field in Vietnam.⁷ Not providing an explicit conclusion that SOEs face soft budget constraints, they find that the degree of difficulty in terms of ‘access to financing’ and the ‘cost of financing’, private firms scored 2.43 and 2.06 respectively and SOEs 2.21 and 2.28 (*ibid.*: 12).⁸ It is not clearly mentioned that whether the difference in these numbers has significance even if we ignore the fact that number 2 means a ‘minor’ obstacle. It also is unclear why private firms which felt that the access to financing is more difficult answered that the cost of financing mattered less than what SOEs felt.

Malesky and Taussig (2009)⁹ also find that having connections is important in doing business in Vietnam and connected *private* firms¹⁰ are significantly more likely to receive

⁶ Indeed, after subsidised prices for input materials were finally abolished in 1989, many SOEs were forced to close down their operations because they were unable to purchase input materials at market prices which were much higher than subsidised prices. This provided fuel for arguments against further hardening of SOE budget constraints (Beresford and Fforde 1997: 123-4).

⁷ The survey set of is composed of 629 private firms and 117 SOEs of which 295 private firms and 70 SOEs were interviewed across eleven cities and provinces.

⁸ The numbers are calculated by assigning a value of 4 if a constraint is perceived as sever, 3 if a constraint is perceived as ‘major’, 2 if ‘minor’ and 1 if no obstacle. The higher the number, the more severe the constraint (Tenev *et al.* 2003: 12).

⁹ Malesky and Taussig (2009) is based on an extensive data set composed of 6,400 firms across all 64 of Vietnam’s provinces but it unfortunately does not include SOEs in their analysis. Detail information of the survey is available at <http://www.pcivietnam.org/>.

bank financing, but they argue that “much of the financing of the most dynamic and fastest growing business activity in the Vietnamese economy takes place *outside* the traditional banking sector” (emphasis added; *ibid.* : 538).¹¹ However, Tenev *et al.* (2003: 73) argue that “no strong direct relationship between degree of *informality* and a firm’s ability to access resources such as bank loans, land, business services, and the court system” (emphasis added).

There are some firm-level analyses which focus on *private firms* and do not directly tackle the issue of soft budget constraints. For example, Hemlin *et al.* (1998) examine the development of small and medium-sized enterprises (SMEs) based on 500 private firms whose firm size in terms of number of workers is below 100. This study did does not focus on budget constraint issue but find that access to bank loans is one of the most significant obstacles (*ibid.*: 41-2). Rand (2005) reaches the same conclusion in the analysis of the credit constraints on 1,119 private firms selected from *Enterprise Survey 2002* published by the General Statistics Office of Vietnam. Cheshier (2010) provides an excellent in-depth analysis of the class formation in Vietnam by examining 200 largest firms in Vietnam and 200 largest Vietnamese firms in which state-owned, privately-owned and foreign-owned firms are included. He argues that the capitalist in Vietnam has largely been connected to the state sector. However, the issue of budget constraints is not the main theme of his analysis.

Lastly, but most importantly, Gainsborough (2005) focuses on the issue of budget constraints based on interviews with 24 private and state-owned firms in four provincial

¹⁰ They used three variables to reflect the connectedness by asking whether the owner of the firm was i) former party, government official, or military officer; ii) former SOE manager; or iii) former SOE employee (Malesky and Taussig 2009: 545).

¹¹ See Allen *et al.* (2005), Hansen *et al.* (2004), Le *et al.* (2006) so-called ‘connection-based’ lending in the private sector and its impact on economic growth.

Vietnam.¹² Like as Tenev *et al.* (2003) and Malesky and Taussig (2009), he concludes that the connections among politicians, managers of SOEs and bankers are a critical factor which influences the softness of budget constraints. His emphasis, however, is put on that the importance of connections applies regardless of ownership type of the firm.¹³ Therefore, it is difficult to draw a general conclusion about budget constraints depending on ownership type. There is no reason to presume that SOEs face softer budget constraints. He argues that

insofar as soft budget constraints (SBCs) are at least in part a consequence of a particular type of relationship between firms and politicians or firms and banks, the differing character of these relationships from one place to another is likely to result in different outcomes (Gainsborough *ibid.*: 3).

Another finding he provides to tackle the softness of budget constraints is firms' reliance on their 'own equity (*von tu co*)' as a source of their investment.¹⁴ He argues that "the heavy reliance on 'own capital' for all firms regardless of ownership type ... suggests that general speaking companies are not specially 'flush' with budget or bank capital" (Gainsborough *ibid.*: 8). This tendency is also found in the interview set of this dissertation while the priority as a source investment slightly moves toward bank loans (see Chapter 6).

While Tenev *et al.* (2003), Gainsborough (2005) and Malesky and Taussig (2009) provide insightful comparative analyses of budget constraints between SOEs and private firms, budget constraints among SOEs are still largely unknown. This dissertation

¹² His sample set is composed of two locally-managed SOEs, two equitised SOEs and two limited liability companies from each of four locations (Hai Phong, Lao Cai, Tay Ninh and Can Tho).

¹³ The distinction between a state-owned or privately-owned is quite complicated in Vietnam and thus it needs further explanation. See Chapter 2 about murky property rights in Vietnam.

¹⁴ *Von tu co* is translated into either 'own capital' or 'own equity'. See Chapter 2 and 6 for more detail discussion of own equity.

addresses this issue and collected data from SOEs only by applying the methodology of Gainsborough (2005). The survey sample is composed of twenty-two locally-managed and centrally-managed SOEs including five equitised SOEs which operated in Hai Phong in 2005.¹⁵

Budget constraints on SOEs in Vietnam: Findings

To address the issues of soft budget constraints, the interview asked four questions to interviewees.¹⁶

- Whether the SOE has the support from the state or local budget
- Whether the SOE has tax break or tax exemption
- Whether the SOE has an obstacle to getting bank loans
- *How does the SOE director think about bailouts?*

While there are limited number of SOEs in the sample, findings from the analysis of the interview are consistent across SOEs. We can point out two main findings here before examining the interview in detail in Chapter 6.

Firstly, the budget constraints on SOEs have tended to be ‘hardened’. Providing financial support to SOEs has changed over time. Direct support from the state or provincial budget dramatically decreased since the late 1990s whereas indirect support through the banking system, particularly through state-owned commercial banks (SOCBs), has been a main channel. This finding coincides with that of Gainsborough (2005) and the cases observed in the former Eastern European planned economies (Kornai *et al.* 2003). Also there was no lax application of taxation rules and it has been harder to get bank loans. Meanwhile, in terms of the expectations of being bailed out among SOE directors, most of them answered that they do not think the state has to bail loss-making SOEs out but

¹⁵ See Chapter 5 for detail of data collection.

¹⁶ The interviewees were either directors or vice directors of interviewed SOEs. This dissertation calls them ‘SOE directors’ or interviewees.

directors must take responsibility for the loss. The expectations of SOE director have moved towards 'hard' budget constraints.

Secondly, while the SOE directors answered that the state regulations made the access to capital more and more difficult since the late 1990s, not all the interviewed SOEs faced the same level of softness in budget constraints. *Some of large centrally-managed SOEs faced relatively soft budget constraints than small locally-managed SOEs and equitised SOEs did.* The directors of centrally-managed SOEs in general were quite confident in terms of their ability to get bank loans and also they 'expected' that the state would help them if something happens. In contrast, the directors of locally-managed SOEs and equitised SOEs did not strongly express the same confidence. As Cheshier (2010) argues all SOEs cannot be the same in terms of size and connections.

These two finding appears conflict each other but it is not unusual in Vietnam. Vu Quoc Ngu (2002: 9-10) argues that SOE reform measure showed mixed signals between 1990s and 2000s during which the state was determined to downsize SOEs on the one hand and also "subsidies were given to loss making SOEs in the form of direct grant, postponement of taxes, rolling-over or writing-off of the bad debts". According to *Vietnam Economic Times* (No. 64, 2000), for three years from 1997 to 1999, state budget directly financed SOEs with nearly VND 8,000 billion. SOEs were also exempted from paying taxes amounting to VND 2,288 billion and their bad debts estimated to be VND 1,088 billion were written off. This made the amount that SOEs received from state budget greater than the amount they contributed to it.

How can we interpret these seemingly conflicting findings? Do budget constraints harden or soften? If we remind that the key respect of the soft budget constraints syndrome is the establishment of expectation of bailouts and together with other findings, we may conclude that the SOEs in Hai Phong face harder budget constraints. On the other hand, if

we focus on the second finding, we cannot say the SOEs in Hai Phong face hard budget constraints. At least some of them seem to have softer budget constraints.

Beresford (2008) may support that the budget constraints on SOEs has been hardened. In a review of *doi moi*, she seeks the reason why the state sector was awarded political privilege under *doi moi*, but has been unable to seize the commanding heights of the economy from the fact that the state's inability, especially under donor pressure, to provide crucial investment support to the state sector and the lack of strong state coordination leaves scope for increasing influence of sectional business interests in politics.

What we can surely say is that conventional wisdom on the 'soft' budget constraints on SOEs needs to be revised. As Gainsborough (2005: 3) says "it is unlikely to be a simple yes or no answer" because budget constraints can be soft or hard largely depending on the state's policy and individual or a group of SOEs are likely to face different types of budget constraints within the same tide.

Gainsborough (*ibid.*) provides an insightful analysis of how the political economy of budget constraints works in a nexus of individual firm-politician-banker and focuses on individuals' inter-relations and their influences over budget constraints on individual firms at the micro-level. This dissertation complements his analysis by explaining the finding that the large SOEs in Hai Phong face softer budget constraint while SOEs in general face hard budget constraints. This is the outcome of the pursuit of government policies whose priority is given to maintaining the dominance of the state sector. The state wants to keep this priority at minimum cost. While the SOE director wants to maximise his/her pecuniary and non-pecuniary gain.

Budget constraints: a proxy of state-business relations

As we examined earlier, bailouts involve political decisions. These are the outcomes of the negotiations between the state and SOE directors. Although doing bailouts is determined solely by the state, the decision is most likely to be affected by how the relations between the state and SOEs directors are formed (Gainsborough 2005). Depending on this, the softness of budget constraints which each or a group of SOEs face is likely to vary.

Why does the state decide to bail them out? Kornai (1980, 1998, 2001) suggests that socialist states decide bailouts because of their paternalism. Contrary to Kornai, Dewatripont and Maskin (1995) argue that paternalism is neither a necessary nor a sufficient condition for soft budget constraints. They show that the transaction cost is an important factor in determining bailouts. In a decentralised economic system, the *ex post* cost of refinancing bad projects is so high that doing bailout is inefficient, which hardens budget constraints. Similarly Qian and Roland (1998) suggest from the Chinese experience that as the fiscal system has become more decentralised over the reform, the competition among provinces and thus refinancing bad projects becomes not economical.

There are a series of analyses arguing that the state bails loss-making SOEs out because it can obtain some kind of benefits. For example, public ownership of a firm in which both the state and the private sector has a stake can contribute to soften budget constraints (Li 1992). Boycko *et al.* (1996) suggest that politicians may want to provide SOEs with financial support to ease the pressure of unemployment, which could benefit the politicians in election.

On the other hand, some studies show that privatisation is not a solution to remove the soft budget constraints syndrome. For instance, Röller and Zhang (2005) argue that firms in socialist and transitional economies are likely to have soft budget constraints because

they are often obliged to provide both social goods and private goods simultaneously. Under this situation, politicians are unlikely to commit not to bail out firms experiencing financial trouble. Similarly Lin and Li (2008) show that when the state impose policy burdens such as keeping employment or doing business in uneconomic strategic areas¹⁷ on SOEs or privatised firms, they are likely to have soft budget constraints. Hence, privatisation will not eradicate soft budget constraints but exacerbates as long as the firms undertake policy burdens.

This dissertation extends Gainsborough (2005) and Lin and Li (2008) by incorporating the specificity of Vietnam's political economy. The specificity of Vietnam results directly from its political system whose summit is the Communist Party of Vietnam (CPV). Vietnam, as its Constitution declares, still maintains the principle of single-party rule which guides the 'socialist-oriented' market economy in which the state sector is presumed to dominate the economy.¹⁸ If the dominance of the state sector is challenged, it is likely that the state will lose the credibility of people given that the majority of Vietnamese have both direct and indirect relationships with the state sector including the CPV (Cheshier 2010, Dang Phong and Beresford 1998, Gainsborough 2010b).¹⁹ The dominance of the state sector is likely to be a telling indicator reflecting the influence of the CPV over society. Discontent of the supporters can put pressure to the state and the

¹⁷ Lin and Li (2008: 92-3) identify two types of policy burdens: a social policy burden and a strategic policy burden. The social policy burden refers to keeping redundant workers, providing retirement pensions and other social services while the strategic policy burden stems from that fact that the enterprises are forced to enter the industries which they do not have comparative advantage.

¹⁸ See Article 51 of the Constitution of the Socialist Republic of Vietnam revised 28th November 2013. Also the People's Army has responsibility to protect the CPV as declared in Article 65: "The people's armed forces shall show absolute loyalty to the Fatherland, the People, the Party and the State".

¹⁹ It is very difficult to differentiate the state and the CPV because of overlapped responsibilities between the state and the CPV. For example, the President and the Prime Minister are also members of the Politburo of the CPV, so is the Chairman of the National Assembly.

CPV even though the voting power of the people is not properly reflected in general elections (Fforde 2011).²⁰

A dichotomy between politics and economy expresses the importance of maintaining the legitimacy of the CPV in Vietnam. Beresford and Fforde (1997) suggest that the co-existence of the reformers and the conservatives within the CPV under the name of the balance of power can be explained by examining how the leadership of Vietnam has tried to keep socialism. They argue that the Party leadership have operated two principles to protect socialism: ‘definitional’ principle and ‘operational’

“The definitional principle defines socialism in terms of public ownership of the means of production, central planning, and distribution according to labour productivity whereas the operational principle includes a central monopoly of foreign trade, a state monopoly over the domestic circulation of goods, cooperative production in agriculture and the handicraft industry, planning of industrial production, state control of finance and credit, state determination of virtually all prices and planned allocation of labour” (Beresford and Fforde *ibid.*, 112).

According to this framework, both the conservatives and the reformers within the CPV aim at keeping socialism, but the reformers are the group who attempt to *strengthen* socialism by modifying the operation of the system.²¹ As a result of the compromise

²⁰ Nonetheless, the election at local levels in particular at the commune level is different from the nationwide general election. At the commune level, the voting power of the constituents has tended to reflect more directly albeit a tension between the people and the CPV is expressed (Fforde 2011).

²¹ While the CPV has been the centre of the power structure in Vietnam, it does not mean that their dominance has been left intact (Beresford 2001, Fforde 1993, 2007, Gainsborough 2003c, Vasavakul 1996). “Dismantling the old administrative control and command mechanism over production units ... created a vacuum that was filled by more informal systems of control and ownership. The grant of commercial freedoms resulted in a virtual appropriation of state property by managers, bureaucrats and Party officials. On the other hand, this may have succeeded in releasing power that resulted challenged the authority

between these two factions, the feature of the political economy of Vietnam was formed: politically conservative but economically pragmatic (Rama 2008).²² Even though there has been modification in the operation of the socialist system, the Vietnam's leadership have not given up the idea that the state sector must hold a leading role in the national economy. In this context, individual politicians in the state apparatus are allowed to seek their personal interests and consequently it might cause a negative effect on economic growth, but if these gain-seeking activities are likely to threaten the political regime, it would not be tolerated. This works as a significantly strong constraint on the behavioural pattern of politician and SOE director.

This dissertation assumes that individual politicians not only serve their own interests but also their behaviour is restricted by the interests of the state.²³ In our analysis, as a result, the state is considered as an entity to pursue its *own interests* instead of as an aggregated set of individual politicians maximising their gains, which can cause the problem of coordination failure or collective action (Olson 1965, 1982). The state seeking its own interests is not necessarily benevolent and thus its interests do not inevitably coincide with the public interest. The interests of the state may include maximising its budget revenue, increasing its influence over SOEs and the most importantly maintaining the current political system in which the CPV stands at the summit (Fforde 2007). Among these, the first priority of the Vietnamese state is to keep the 'socialist-oriented' market system in which the state sector dominates and plays the leading role in the economy as

of the state and the legitimacy of the Party, particularly where they were associated with corruption and other abuse" (Painter 2005b: 274).

²² Some studies view this tension has dragged reform process in Vietnam. The different views of these two groups tension made it difficult to make hard reform policies. Furthermore, the so-called 'democratic centralism' or the collective leadership system makes decision-makings harder and longer. This 'balance-of-power' nature of Vietnam's politics has added more difficulty in setting up and implementing reform drive strongly (Abuza 1998, Dinh Quan Xuan 2000, Sidel 1997).

²³ Fforde (2013) argues that there is no domestic sovereignty in Vietnam which makes it possible for the state (or the CPV) to pursue policies without being interrupted by others. See Chapter 2 for more detail.

announced in its Constitution.²⁴ If we put it another way, keeping the leadership of the CPV is the top priority in the state interests.²⁵

The benefit which the state expects to obtain by bailing loss-making SOEs out is not pecuniary but political one. It can consolidate its constituency and its legitimacy by keeping the leadership of the CPV and the dominance of the state sector. On the other hand, the associated cost is likely to be both pecuniary and political one. Bailouts evidently piles up public debts. If, however, the state let loss-making SOEs die, the state is likely to lose the confidence of people. This is the political cost but it can reduce the burden on the state budget by not providing financial support.

If the state maximises its interests by considering the cost and the benefit, it is likely that it would choose to help a large SOE over a small one when both of them make a loss. Given that a failure of a large SOE will draw immediate attention of people, letting it die can impose a political burden on the state because this may give a wrong signal to people that the state would let its dominance be seriously waned.

²⁴ Dr Vo Tri Thanh, a well-known Vietnamese economist, says that Vietnam needs market but should be ‘under state management’ by ‘socialism orientation’ through a leading role of the state sector in the economy (Vo Tri Thanh 2009)

²⁵ But at this state we have an unanswered question. For what reasons do the CPV leadership want to initiate the changes in budget constraints? The interests of the organised groups are likely to be affected a certain extent when significant transitions occur in socio-economic settings. Although it is generally assumed that powerful interest groups prefer to maintain the *status quo*, there is no reason to presume such a behavioural pattern. This preference for the *status quo* shown by powerful interest groups could better be understood in the sense that the *status quo* is likely to be a product of the unceasing efforts of organised powerful groups to develop socio-economic institutional settings which best fit to serve the achievement and preservation of the interests of these groups. Unless institutional changes are highly likely to create higher benefits for organised powerful groups – of course factions within the organised powerful groups may have conflicts of interests, they are likely to choose an option to keep the *status quo*. Instead interest groups will compare what they will either lose or obtain from different strategies of change, and these benefits and costs will vary according to the political and economic organisation of the interest groups.

Whereas SOEs are considered as one of state organs, it is not necessary to presume that the interests of the state and those of SOE directors are identical. Rather, it is more likely that the interests of these two parties are different. We, however, do not need to deny a possibility that both parties may have the same interests such as promoting economic growth and serve the public. Because the state and SOE directors have different interests, conflicts of interests are unavoidable whenever new policies applicable to SOEs are introduced.²⁶ The top priority of SOE directors is to keep their position from which they can obtain official wages and non-pecuniary revenues. In order to keep their position, the SOEs they serve must not make a loss repeatedly. Also directors aim to gain more autonomy from the state in terms of business operation.

Modelling the behaviour the state and SOEs directors

It is assumed that both the state and SOE directors maximise their payoff. In the model used in Lin and Li (2008: 94-5), the payoff of an SOE director is denoted by

$$(1) U_D = w - e(q)$$

where w denotes the director's wage and $e(q)$ the director's effort paid in producing the q amount of output.

The payoff of the state when it provides financial support is denoted by

$$(2) U_S = B(L) - S$$

where $B(L)$ represents the benefit of the policy burden to the state and S the amount of subsidy the state provides when the SOE makes a loss equivalent to $|\pi(q) - L|$ in which $\pi(q)$ denotes the firm's profit and L the policy burden on the SOE.²⁷

²⁶ Interests-maximising activities of the state and SOE directors are described as a game of re-centralisation and decentralisation played by the state and SOE directors (Fforde 2007, Gainsborough 2003c). A discussion on this issue is made in Chapter 2.

²⁷ If there is no subsidy, the payoff function will be $U_S = B(L) + \pi(q) - L$.

While the wage might be an important factor determining the payment for the SOE director, this dissertation assumes that the SOE director is more interested in maintaining their position because he/she is likely to obtain extra pecuniary or non-pecuniary revenue derived from the position, given that the official wage for them is quite low in Vietnam.²⁸

Nonetheless, we cannot ignore the fact that whether the SOE director can keep his/her position is directly related to the performance of the SOE which he/she works for. If the SOE records a loss for two or three years *consecutively*, the director is to be dismissed. Therefore, the SOE director has to put effort in revenue seeking in order to avoid making a loss. Practically, however, keeping the position is closely related to the connections the director has established. Furthermore, we have to consider that the SOE director now has to put his/her effort into both revenue seeking and connections management, which has a trade-off relationship. If he/she devotes α effort in revenue seeking, $1 - \alpha$ effort should be devoted to connections management.

The revised payoff function of the *SOE director* is

$$(3) \quad U_D = w + w_n - \alpha \cdot e(q) - (1 - \alpha) \cdot e(c)$$

where w_n represents the non-pecuniary revenue and $e(c)$ the director's effort put in managing his/her connections. The payoff of the director depends on his/her pecuniary and non-pecuniary revenue and his/her effort put in formal and informal activities in the form of time and money. It is highly likely that the type of connections which the director has established greatly influences over the lobbying for financial support in the case of loss-making. A better-connected director is more likely to have favoured support from the state.

²⁸ For example, the Ministry of Industry determined the wage for directors of the largest SOE, Petro Vietnam, between VND 32 and 36 million per month in 2013, which is equivalent to USD 1,600 and 1,800 (<http://baodatviet.vn/kinh-te/dai-gia/soi-bang-luong-sep-tap-doan-doanh-nghiep-nha-nuoc-3053499>).

Designing the payoff function of the state, we consider three cases. Firstly, if an SOE makes a profit, the state does not need to provide financial support and its tax revenue increases. Its political benefit increases or unchanged. Secondly, if an SOE makes a loss and the state chooses to bail this loss-making SOE out. As a result, the state bears an economic burden with reduce tax revenue. The state, however, alleviates its political burden by maintaining the state sector dominance through the bailout. Thirdly, if an SOE makes a loss and the state choose not to bail the SOE out. This incurs the political burden on the state and also reduces tax revenue.

The revised payoff function of the *state* can be defined as follows:

$$(4.1) \quad U_G = \overline{B(P)} + T \quad (\text{if } \pi(q) > 0)$$

$$(4.2) \quad U_G = \overline{B(P)} - T - S \quad (\text{if } \pi(q) < 0 \text{ and there is subsidy})$$

$$(4.3) \quad U_G = \overline{B(P)} - C(P) - T \quad (\text{if } \pi(q) < 0 \text{ and there is no subsidy})$$

where $\overline{B(P)}$ denotes a given political benefit which can be obtained from the dominant state sector, $C(P)$ political burden resulting from the weakened state sector, T the amount of tax revenue and S the amount of subsidy.

In contrast to the assumption of Lin and Li (2008) that the payoff of the state has a negative relationship to the amount of the subsidy, the financial support has a positive effect upon the payoff of the state. It enables the state to keep the political benefit without adding the political burden although it is not explicitly observed in the payoff function (4.2).

In the case of loss-making, the state has to compare its payoff (4.2) with payoff (4.3) and the decision will depend on the condition of $C(P) \gtrless S$. We can assume that the state will choose to subsidize if the political burden is larger than or equal to the economic burden, i.e. $C(P) \geq S$.

What if the political burden is smaller than the economic burden? It is not a straightforward matter because keeping the current political system and the dominance of the state sector is a top priority of the state. It implies that $C(P)$ should be weighted or S is multiplied by θ , where $0 < \theta < 1$. The higher priority is put on the state sector dominance the smaller the size of θ is. Taking into account this condition, the state will choose to provide financial support as long as $\frac{1}{\theta} C(P) < S$.

How long the state will be able to subsidize is entirely dependent upon its fiscal capacity. It implies that the state cannot bailout every single loss-making SOE. It is likely that the state chooses an SOE which carries the largest political and economic impact at the given economic burden. It is apt to pick a large SOE rather than a small one. It explains why large SOE face relatively softer budget constraints than other SOEs.

Furthermore, Vietnam might have been constrained by the influence of international organisations and donor countries because the more Vietnam opens to the world, the more constraints were imposed for the return of foreign aids and investment funds, particularly from the multilateral organisation such as the World Bank and the Paris Club.²⁹ It is not difficult to guess that Vietnam had to show its good faith to donor countries somehow by not rejecting the policy advices strongly (Kolko 1997). Vietnam corrects its strategies more or less according to the recommendations from those organisations.

²⁹ The Paris Club is a multilateral organisation, composed of twenty countries such as France, Japan, Sweden, Denmark, Finland, Belgium, Germany, Australia, Italy, etc. and sixteen international organisations. It held a conference co-chaired by the World Bank and the UNDP in Paris in 1993 in order to help clear the debt of Vietnam to the IMF amounted to 1.86 billion USD. Vietnam requested to disburse 650 million USD of it by 1994 and it was accepted which was quite a rare case in the history of international aid (Kolko 1997).

Nonetheless, it does not mean that Vietnam has actually followed the advice of the donor community. The Vietnamese state manages such pressure by “appearing to sign up to things without then moving to implement them (a kind of 'take the money and run' approach).” (Gainsborough 2010a: 483).³⁰ It is argued that the CPV leadership, in fact, have modified the state sector reform policies which are based on the recommendations of the donor countries in order to ensure, instead of weakening, the authority of the Vietnamese state (Painter 2005a, 2006).

Concluding remarks: The behaviour of the SOE director and the state

The SOE director maximises his/her payoff by allocating his/her effort either in official revenue seeking activities or in unofficial connections management. This allocation of his/her effort is likely to depend on the market power of an SOE. If the SOE has monopoly power, it is likely to make a profit. Of course, not all SOEs having monopoly power make a profit especially when they have to deliver social services to the public despite higher production costs. If the SOE confronts competition, it is less likely to make a profit given its inefficiency and competition pressure from private firms.

The likelihood of financial support from the state will affect the effort allocation of the SOE director. If the state is mostly likely to provide financial support, the director would put more effort in managing connections. If, on the contrary, the state is unlikely to provide financial support, the director would put more effort in revenue seeking.

³⁰ This clever scheme of the Vietnamese state however has not resulted in a ‘bad’ relationship between Vietnam and donor communities because of the coincidence of the interests of each other. See Gainsborough (*ibid.*, 484).

Table 1: The behaviour of the SOE director

SOE's market power	Monopolist	Competitive
State subsidy	Likely to make a profit Spend more effort in $e(c)$	Likely to make a loss Spend more effort in $e(c)$
No state subsidy	Likely to make a profit Spend more effort in $e(q)$	Likely to make a loss Spend more effort in $e(q)$

When the SOE director expects that the state is likely to provide financial support, he/she puts more effort into managing the connections regardless of the market power of the SOE. On the contrary, if the SOE director anticipates that the state is unlikely to provide financial support, he/she devotes more effort into official revenue seeking activities whether the SOE has market power or not.

The state's preference for large SOEs in the decision of providing financial support enhances the SOE director's expectation. In turn, this would influence the profitability of the SOE. The expectation of being bailed out makes him/her pay more attention to establishing the connections and managing them than to improving operation of the firm. This behavioural pattern is likely to lower the profitability of the SOE.

As shown in Table 1 above, the behaviour pattern of the state and the SOE director causing discriminated soft budget constraints among SOEs in Vietnam is summarised as follows:

- i) The director of a large SOE having monopoly power is likely to put more effort into managing the connections.
- ii) The SOE is likely to make a loss because the director spends less effort into running businesses.
- iii) The director has better connections is likely to have favoured financial support.

- iv) The state prefers the large SOE when it decides bailouts.

If this process is repeated, the discriminated soft budget constraints on the SOE would be embedded in politics and economy. As Gainsborough (2005) argues the softness of budget constraints is affected by the connections in which politicians, SOEs director and bankers are intertwined. This dissertation develops this idea by showing that the softness of budget constraints can be determined structurally through the behaviour of payoff maximising state and the SOE director.

The plan of the dissertation

We review literature on SOEs reform policies by dividing the period 1975-1990 and 1991-present to examine the changes in budget constraints to SOEs and how the state-SOEs relations change in Chapter 2 and then review the literature on the rational of SOEs and examine the development of government-linked companies (GLCs) in Singapore and Malaysia in which similarity to Vietnam is found in terms of the dominance of the state sector and the blurred distinction between the state and the private sector in Chapter 3. We describe the dominance and the performance of SOEs of Vietnam in Chapter 4 and then explain the methodology used to collect data in Chapter 5. We analyse the data set to examine budget constraints on SOEs in Hai Phong in which no strong evidence of ‘soft’ budget constraints on SOEs is found but a group of SOEs have better access to bank loans in Chapter 6. At last, we draw a conclusion and point out the limitation of this dissertation in Chapter 7.

2. State-owned enterprises reform policies in Vietnam

The symbolic significance of *doi moi* declared at the Sixth National Congress³¹ of the CPV in December 1986 gives people the impression that *doi moi* was a single event having strong impact.³² However, *doi moi* were a set of continuous trials and policies towards a market-based economy through which the state legalised some market activities which were considered as ‘out-of-plan’ but widely adopted in the state sector (Beresford and Dang Phong 2000, Cheshier 2010, Fforde 2007, Rama 2008).

2.1. Reform in general

After national reunification, Vietnam (the Socialist Republic of Vietnam) extended the economic model established under the regime of the Democratic Republic of Vietnam (DRV; North Vietnam) to the domain of the former Republic of Vietnam (South Vietnam) while at the same time strengthening the economic model of the Democratic Republic of

³¹ It is said the draft of the Political Report of the National Congress circulated at the start of 1986 was extremely conservative. However, the death of the then General Secretary Le Duan changed the situation dramatically. Truong Chinh who replaced Le Duan guided the editing of the Political Report which became extremely reformist (Fforde 2007: 189).

³² Symbolic speeches of two then General Secretary of the CPV are as follows:
“Over the past years we have committed errors springing from “left infantilism” and voluntarism and from running counter to objective laws. These errors have manifested themselves in the fact that we have built an economic structure over-emphasizing large-scale heavy industry and surpassing our possibilities; that we have maintained for too long a bureaucratic subsidy-based system of management in which the infrastructure could not support a huge superstructure, leading to a great deal of dependence on foreign aid; that we have been precipitate in seeking to complete socialist transformation by quickly doing away with all non-socialist components of the economy. For the community of socialist countries, renovation is the way leading to the satisfaction of the requirements of the time, of the legitimate and ever-increasing needs of the people. For our country, renovation is all the more necessary: it is a matter of vital importance” (Truong Chinh 1986: 4-5);
“In order to make the situation change, this Sixth Congress should make a renovation of our party in the fields of thinking, working style, organization and cadres. ... To this end, we have to struggle against the old, against conservatism and sluggishness, against dogmatism and stereo-typism, against subjectivism and hastiness, against degeneration and depravity, against those die-hard and obsolete habits” (Nguyen Van Linh 1987: 14).

Vietnam in the northern part. It was stated by a top leader of the Communist Party of Vietnam, Truong Chinh, the former General Secretary and a Politburo member, that “both zones must carry out together the socialist revolution and socialist construction at different levels. The North, which is ahead of the South on the road of transition to socialism, has now to do its best to help the South catch up with it.”, at the Political Consultative Conference on National Reunification held in November 1975 after the Fall of Saigon on 30 April 1975 (Truong Chinh 1975: 3).

However, there were a series of debates within the leaderships of the CPV whether the extension of the DRV economic system³³ to southern Vietnam should be done immediately or required a trial period (Rama 2008: 13-5). Whereas the leadership put the emphasis on economic restoration rather than transition at the beginning, the focus got started moving towards a single socialist economic system both in North and South (Beresford 1988, Fforde and de Vylder 1996, Ljunggren 1993, Vo Nhan Tri 1990). Enterprises were requested to form joint ventures with the state in 1976 and the collectivisation in the agricultural sector began in 1977 and a campaign denouncing large-scale trade was launched in 1978 (Ljunggren 1993: 59).³⁴

³³ The DRV economic system refers the Vietnamese version of neo-Stalinist model which has the central planning system and the use of microeconomic institutions like as cooperatives and SOEs in common (see Introduction of Fforde and de Vylder (1996)).

³⁴ This was the response by the leadership to the remnant of capitalism in the South. The vestiges of capitalist institutions and perceptions in the southern part of Vietnam, in particular within the sector of circulation and distribution, were a nuisance for the central authority in Hanoi trying to achieve socialist economic management. The two-price system, combined with the remnants of capitalism, provided individual agents with the opportunity of profiteering through unlawful market trade activities. This, in turn, caused a shortage of goods distributed through state market channels. While the state was unable to secure goods, these goods were traded in unauthorised markets at higher prices. The socialist state management was therefore distorted. Plenty of documents in the *Party Daily (Nhan dan)* and the *Party Monthly (Hoc tap* which changed its name into *Tap chi Cong san* in 1977) pointed out this type of problem over the period.

Insufficient procurement of necessary consumer goods and foodstuffs, aggravated by natural calamities, affected the central authority's perception of the efficiency of the state management system. Pham Van Dong (1978), the then Prime Minister and a member of the Politburo, stressed a focus on agricultural production as well as supporting industry and crafts that were producing consumer goods to meet the peoples' demands for foods and daily necessities.³⁵ In contrast to the emphasis of Mr. Pham Van Dong, the investment in heavy industry increased from 21.4 per cent in 1976 to 29.7 per cent in 1980 (Vu Quoc Ngu 2002: 3). Large investment in heavy industry changed in the early 1980s and the productivity in the industrial sector improved (see Table 2, p. 43).

However, the CPV had faced the fact that the handicrafts and artisan industry and private capitalists which were considered as the out-of-state-sector activities or the tail of the capitalist regime and treated unfavourably could produce and develop some state sector goods more efficiently, and the Sixth Plenum held in August 1979 accepted the important role of those activities in fulfilling people's demands for daily consumer goods.³⁶ Now what mattered were not the forms of production but the efficiency of the production. All ownership forms had to be fully utilised to meet the urgent task of providing consumer goods and food products.³⁷ At the same time, the so-called 'still-surviving petty bourgeoisie' in the circulation and distribution sectors of basic consumer commodities, especially in the southern part of the nation, was blamed for the economic difficulties by the leadership (Le Duan 1984, Le Duan and Pham Van Dong 1975).

³⁵ It was a deviation from the propaganda of the Fourth National Congress of the CPV which gave priority to the development of heavy industry. It was a slight modification in the means to achieve the goal of socialist transformation in Vietnam, as Pham Van Dong himself clearly pointed out in his speech. There was no official acceptance so far of the possible errors in the economic plan and its implementation.

³⁶ Some scholars view the Sixth Plenum of the Fourth National Congress of the CPV as an important turning point from which the Vietnamese leadership had set the idea of reform in their mind (Fforde and de Vylder 1996, Nguyen Khac Vien 1982).

³⁷ At that time, there were three ownership forms – state, collective and individual – in the north while five ownership forms existed in the south – joint state-private and private capitalist ownership in addition to those three forms.

Vietnam's pre-reform situation was characterised by low savings rates, negligible agricultural surpluses and heavy reliance on foreign aid. While reforms boosted Vietnamese rural incomes³⁸, the continued state monopoly of agricultural input supplies and certain product markets dominated by SOEs deprived farmers of a larger share of agricultural productivity gains (Fforde 1999). State credit allocations – the lion's share of all formal credit – continued to favour state enterprises. Relying on owners' savings, reinvested profits and small-scale informal sector borrowing, these enterprises generally remained small and undercapitalised (O'Conner 1998: 13-4).³⁹

In the agricultural sector, for example, Government Resolution No. 9/CP on 'Food Policy' in 1980⁴⁰ and Politburo Directive No. 100-CT/TW on 'Improving and Extending Contract

³⁸ Refer to Hy Van Luong and Unger (1998) and Kirkvliet and Selden (1998) for an in-depth analysis of rural development during the early period of reform.

³⁹ The Chinese rural industry can be a good reference to assess the role of the rural economy in economic growth. In China, the central government actively encouraged the growth of the non-state sector. The collectively-owned township and village enterprises were a key element of this aim. Economically, on the one hand, they provided an organisational form conducive to mobilising local savings and pooling risk, politically, on the other hand, their ownership could be reconciled with official socialist ideology. The number of township and village enterprises roughly doubled to over 23 million between 1985 and 1996. The labour force employed by the township and village enterprises also roughly doubled over the same period to 135 million people. Thus, the employment level of township and village enterprises rose from 19 to 28 per cent of rural employment. Over the same period, the TVE contribution to gross industrial output rose even more steeply, from under 20 per cent to 55 per cent (O'Conner 1998: 21-2).

⁴⁰ The title in Vietnamese is *Nghị quyết số 9-CP về chính sách lương thực*. It stipulated new methods of production, collection, collection, purchase and distribution of food in order to incorporate the circulation and distribution of food products within the state sector by introducing agricultural tax and an incentive system. The amount of agricultural tax imposed was an average ten per cent of the volume of produced grain payable in grain and the obligatory sales of grain to the state. In addition, for the creation of the incentive to increase productivity, a new distribution method based on personal performance was designed and substituted for the existing predetermined quantity distribution norm. The new method was designed to give each according to his/her work (SWE, FE/6405/C2/1-6, 26 April 1980).

System in Agricultural Cooperatives' in 1981⁴¹ showed significant movement towards a 'socialist' market economy by approving a contract system which was commonly adopted among cooperatives particularly in the South.⁴² At last, the Party leadership issued Politburo Resolution No. 10-NQ/TW on 'Reforming the Management of the Agricultural Sector' in 1988⁴³ to deal with a serious shortage of food, which led to the decollectivisation of agricultural cooperatives and transformed the character of agricultural cooperatives from rigid centrally planned entities to flexible autonomous commodity producing units.⁴⁴ The size of large cooperatives was adjusted; various combinations of labour and means of production were allowed to organise new cooperatives and production brigades⁴⁵; and land was allocated to tillers for a period of ten to fifteen years by a contract.⁴⁶ Most means of production owned by collectives were

⁴¹ It was issued by the Secretariat (*Ban Bí thư*) of the CPV. The title in Vietnamese was *Chỉ thị số 100-CT/TW về cải tiến công tác khoán, mở rộng khoán sản phẩm đến nhóm và người lao động trong Hợp tác xã nông nghiệp*. The party leadership endorsed the application of the end-product contract system which was already widespread in 1980. There was a custom in rural areas that the cooperatives signed contracts with the individual farmers for the production of winter crops independent of the state production plan. It was initiated by the cooperatives themselves and witnessed well-performed results. More and more cooperatives adopted this end-product system and it was finally applied to the rice production in 1982 by the central authority (the Communist Party of Viet Nam 1986).

⁴² It was reported that there was an increase in food production of twenty-seven per cent during the 1981-1985 period and ninety-two per cent of northern households recorded 5-20 per cent surplus of food production between 1984 and 1985 (Nguyen Phu Trong *et al.* 1995).

⁴³ The title in Vietnamese was *Nghị quyết số 10-NQ/TW về đổi mới quản lý kinh tế nông nghiệp*.

⁴⁴ According to the *Statistical Yearbook* of Vietnam, the production of paddy rice grew at 12.6 per cent in 1988 and at 11.7 in 1989, while the growth rate was just 0.8 per cent in 1986 and -5.6 per cent in 1987.

⁴⁵ According to the resolution of the Sixth Plenum (the Sixth National Congress of the CPV) in March 1989, agricultural cooperatives and production brigades are "business organisations which are established by labourers who pool capital and labour force on voluntary basis and are managed in accordance with democratic principles" (Dang Duc Dam 1995: 56).

⁴⁶ The land allocation over the decollectivisation was conducted based on egalitarianism because of the pressure from the rural communities. As a result, the size of unit plot to the farmers was nearly even to all farmers. The problem, however, was that the plots were scattered because of the rule of egalitarianism. The small scale cultivation caused slow

either sold to individual households or commercialised for lending. Output could be sold freely at market prices either to the government or to the open market. The decollectivisation, however, caused another problem as the functions provided by cooperatives were strongly damaged due to the severe cut of budget after 1989 (Beresford 2006: 208).

The situation in the industrial sector was not quite different from that in the agricultural sector. There were widespread out-of-plan activities of SOEs which faced improper input allocation by the central planning system but still were required to fulfil product targets.⁴⁷ Through those out-of-plan activities, SOEs sometimes had sought to increase cash incomes, or the income in kind paid to workers. Alternatively, disposal of minor products enabled the SOE to obtain inputs used in the production of major lines (Dam Van Nhue and Le Si Thiep 1981: 24; recited in Fforde 2007: 133). SOEs were able to do revenue seeking and in many cases do profit seeking and actively sought those opportunities. Fforde (2007) argues these ‘commercialisation of SOEs’ was one of growth factors in Vietnam before and after *doi moi*.

productivity growth and it became even worse because farmers had to move long distance to work. The egalitarian based land allocation may be counted as a good policy reflecting the demand of farmers but it turned out as a bad policy for the productivity growth in the rural area in Vietnam. On the other hand, it is said that the Chinese government pursued policies that favour those households who already have a head start in what is called a ‘wager-on-the-strong’. It enabled for farmers to have a large scale cultivating plot, which in turn resulted in fast productivity growth in farming in China (Hy Van Luong and Unger 1998).

⁴⁷ This situation was described with a saying in Vietnam ‘scarcity and abundance at the same time (*vừa thừa vừa thiếu*)’. It is reported that there were about two thousand industrial enterprises which hired over 600 thousand workers in 1981. However, one third of the enterprises was idle and operated at half their capacity. Many workers were sent to agricultural and mining sectors and paid seventy per cent of the agreed salary level during their idle periods (Vu Duy Hoang 1982).

Table 2: Industrial output growth (1976-1985)

Annual rate of growth (%)	1976-1980	1980-85
Total	0.6	9.5
State sector	-1.5	8.1
Of which: Central	-3.5	7.8
Local	2.9	8.6
Heavy industry	1.1	6.4
Light industry	-0.6	11.2

Adopted from Vu Quoc Ngu (2002: 5).

2.2. Reform policies in early stages of transition (1976-1990)

Under the socialist planning system the practice of hoarding inputs or self-production of necessary inputs was not an unusual among SOEs in the context of the lack or late delivery of materials through planning system. In addition, SOEs overused allocated inputs because their performance was assessed by the level of fulfilling the plan (Vu Quoc Ngu 2002: 3).

Many important reforms affecting the management of SOEs during the period of 1979 and 1990 can be divided into two types– those that reduced the autonomy of SOEs (recentralisation) and those that increased it (decentralisation) as summarised in Table 3 (p. 45). The enterprise's autonomy over the same period mainly refers to the rights of enterprise directors to set production plans, carry out recruitment, set selling prices and spend their profits. Hence, whether the autonomy is increased or decreased is dependent upon how many of these decisions can be made by directors of SOEs without the approval of higher-level governing organs. Autonomy is also a question of whether SOEs were considered to be independent entities by the state.

When the Vietnamese economy experienced difficulties in the late 1970s and the early 1980s, the leadership tried to improve not only productivity but also the circulation of products within the planned economy. The political leadership believed that the economic problems were the result of the mismanagement of the economic system. Meanwhile, the lack of consumer goods and foodstuffs allocated through the planning system meant that more and more transactions were occurring outside the planning system (*kinh te ngoai*). Of course, profits in the transactions outside the planning system were higher because of the two-price system (official price versus market price).

The government Resolution No. 279-CP promulgated in 1979 and the government Decision No. 25-CP promulgated in 1981 aimed to alleviate the problem of shortages in the planned sector by formalising activities of SOEs that had previously been conducted covertly but were already widespread business activities outside the planning system which are frequently referred to ‘fence-breaking’. Various methods were used in fence-breaking and they were not easy at all because revolutionary people would report to higher levels (Fforde 2007: 61). It, however, should be noted that some big figures in the CPV leadership engaged in fence-breaking. For example, Mr. Kim Ngoc, the Party Secretary of Vinh Phuc province, Mr. Bui Quang Tao, the Party Secretary of Hai Phong and Mr. Vo Van Kiet, the Party Secretary of Ho Chi Minh City who became the Prime Minister were engaged in fence-breaking and were able to persuade the CPV leadership to endorse new methods to improve productivity (see Rama 2008: 15-9).

The government Resolution No. 279-CP was titled “On policies to stimulate and circulate goods not managed by the state and supply materials and goods produced from local materials and waste by-products”.⁴⁸ It encouraged SOEs to increase market activities

⁴⁸ In Vietnamese, *Nghị quyết số 279-CP về chính sách khuyến khích sản xuất và lưu thông những mặt hàng không do Nhà nước quản lý và cung ứng vật tư; những mặt hàng sản xuất bằng nguyên liệu địa phương và phế liệu phế phẩm*.

involving non-list goods. Denunciations of ‘fence-breaking’ activities coming from conservatives in the SOEs were thereafter ignored (Fforde 2007: 146).

Table 3: Classification of SOEs policies between 1979 and 1990

Year	Policies Number	Towards	Main contents
1979	279-CP	Decentralisation	Using non-public channels for distribution
1981	25-CP	Decentralisation	Three Plan System
1982	146-HDBT	Recentralisation	Emphasising the operation of the planned economy
1984	156-HDBT	Recentralisation	Strengthened the role of the state plan
1986	306-BBT	Decentralisation	Granting significant autonomy to SOEs
1986	76-HDBT	Decentralisation	Action plan of 306-BBT
1987	217-HDBT	Decentralisation	Production plans were no longer sent by the centre but set by individual SOE
1989	93-HDBT	Recentralisation	Decreased retainable depreciation in SOEs; increased state budget revenue
1990	143-HDBT	Recentralisation	Outside members sit on the Council of Management weakening the autonomy of the SOE director

The government Decision No. 25-CP, titled “A number of policies and measures to continue to develop the rights in production and trade and to enhance the financial autonomy of SOEs”, introduced the so-called the ‘three plan system’.⁴⁹ It also aimed at

⁴⁹ ‘Three Plan System’ (Government Decision No. 25-CP) defined three plans as follows:

- Plan A: An enterprise produces planned products using state-supplied inputs and supplies the product to the state at low planned prices. Permission to carry out other activities was conditional on the fulfilment of the Part A.

legalising the commercialisation that already characterised most SOEs. After allowing state enterprise to engage in Plan B and Plan C which used to belong to the ‘economy outside planning’, the state again began to emphasise socialist economic management. Partly this was because the improved economic situation made the state feel that decentralisation was already effective in correcting the mismanagement.

It is said that “if there had not been 25-CP then many ‘little crimes’ would have been exposed. One could say that 25-CP ‘muzzled’ many conservative people in the SOEs and saved various managers from the sack. According to the old system such activities were quite wrong, and should have led to losing not only one’s job but also membership of the Party” (quote from Fforde 2007: 61).

Government Decision No. 25-CP on the SOEs reform in 1981

As examined earlier in this section, the Sixth Plenum (the Fourth National Congress) issued a resolution on expanding the production of consumer goods and local small-scale household and handicraft activities. However, the lack of detailed supportive regulations caused confusion and made enterprises hesitant to adopt new ways. Under these circumstances, the government issued a series of policies, Government Decision No. 25, 26 and 64 in January and February 1981, in order to improve the productivity of the industrial sector. The Government Decision No. 25-CP dealt with the continued

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- Plan B: If it was freely disposing of products that it had been established to produce, these were now called the Second Part. The factory was now legally permitted to acquire resources by itself, quite free from planners’ instructions, and could then dispose of them as it wished, but only in order to acquire additional inputs for the fulfilment of Part A.
 - Plan C: Refers to activity concerning so-called ‘minor’ products that resulted from the enterprise’s own attempts at diversification. These were free from outside control, largely because they were not meant to be supplied to established consumers, so there was no demand within the planning system for their supply. However, state trading organs had to be given priority when the unit disposed of these products (de Vylder and Fforde 1988: 68-9).

development of initiatives in production and business and financial *autonomy* of the state enterprises. The Government Decision No. 26-CP dealt with the system of contractual quotas payment and piecework payment and system bonus in state production and business establishments. These decisions were supplemented by the Government Decision No. 64-CP on the remittance of products of state enterprises and the *concentration of cash into the hands of the state* (Vu Duy Hoang 1982).

The Government Decision No. 25-CP⁵⁰, promulgated on 21 January 1981, promoted the initiative of SOEs in production and management and extended their financial autonomy by introducing the ‘three plan system’. The government’s motivations were very similar to those that drove the new policies in the agricultural sector. The existence of the unorganised market and its higher prices had distorted the socialist industrial market, being called ‘bad’ activities by the state. The legalised free market was viewed as a double-edged weapon by the authority because the small scale traders, on the one hand, had helped to stimulate production and fulfil the high demand for consumer goods, but, on the other hand, the allurements of profits pushed them to engage in illicit activities at the same time (*Vietnam Courier*, No. 6, 1983: 11-13). Even SOEs commonly involved in these bad activities, which devastated the economic plan and supply-demand balance.

The Government Decision No. 25-CP can be understood as a method of trying to bring the bad activities into the open and legalise them under state planning. According to the Government Decision No. 25-CP, the priority of meeting obligations under the plan were retained, but state enterprises could register their ‘unplanned’ activities and were allowed to manufacture those unplanned products when they were able to independently procure raw material and energy. It allowed SOEs to expand non-plan and above-plan output

⁵⁰ It was titled “on a number of policies and measures to continue to develop the rights in production and trade and to enhance the financial autonomy of state enterprises” (*về một số chủ trương và biện pháp nhằm phát huy quyền chủ động sản xuất kinh doanh và quyền tự chủ về tài chính của các xí nghiệp quốc doanh*).

(Beresford and Dang Phong 2000: 43) It is reported that a state enterprise in Hanoi recorded a five-fold increase in the plant's revenue and 3.8 times rise in the workers' income from its profit during the 1980-1982 period by applying the 'three part system' creatively.⁵¹

Nevertheless, the two-price system was still cramping the development of the Vietnamese socialist economy as the price gap kept causing side effects. For example, it was highly likely that directors of state firms could appropriate materials, allocated by the state for the production of Plan A products, to use for the production of Plan B and Plan C products which gave bigger benefits to enterprises and workers. In addition, there were differences in the enterprises' revenue which resulted from the price disparity in the two markets. An enterprise which produced tradable goods in free market could have higher revenue.

Conservatism: Decision No. 146-HDBT and Resolution No. 156-HDBT⁵²

Decision No. 146-HDBT, promulgated on 25 August 1982, "On changing and supplementing 25-CP", signalled the state's intention to reduce (and ultimately remove) the production and trade that had been previously allowed in 'the economy outside

⁵¹ For example, the distribution of profits at Giai Phong Plant in Hanoi between 1980 and 1982 was recorded as below.

	(unit: VND)		
	1980	1981	1982
State revenue	223,000	548,000	1,000,000
Plant's revenue	135,883	320,000	700,000
Workers' income	112,560	220,000	430,000

Source: Vu Duy Hoang (1982).

⁵² To indicate the 'government' of Vietnam in legal documents, the Government Council (*Hội đồng Chính phủ* or *CP* in short) was used until 1980 and then the Council of Ministers (*Hội đồng Bộ trưởng* or *HDBT* in short) following the Soviet name was used since 1981. After the collapse of the Soviet in 1992, Government Council, that is, *Chính phủ* (*CP*), was used again for the Government of Vietnam. For the full text of Decision No. 217, see SWB, FE/0033, C1/1-11, on 23 December 1987.

planning'. It confirmed the general intention to limited unplanned activities.⁵³ This Decision was intended to reduce the opportunism of directors who were apt to use supplied materials to produce Plan C products, and also to increase central tax revenues. Three main points of Decision No. 146 were to improve the planning system and centralise sources of commodities in the hands of the state; to get rid of production and trade based upon the unorganised market – enterprises were strictly forbidden from purchasing on the free market those goods subject to the state's monopoly; and to distribute enterprise profits in such a way as to ensure adequate budgetary receipts by the state (Fforde 2007: 164 and 166).

Resolution No. 156-HDBT, promulgated on 30 November 1984, "On some matters for improving the management of state industry",⁵⁴ attempted to strengthen the central economic management organs. It stressed the need to utilise the state plan as a means for concentrating resources by stating that

From the very beginning of 1985, the state plan must centralise principle production conditions for those key goods that serve production, exports, mass consumption, national defence, and goods that create important sources of income from the state budget, above all those enterprises that produce a lot and have high economic results (Fforde 2007: 179).

⁵³ A quoted interview in Fforde (2007: 170) describes the situation as follows. "... because of slackness in management during a situation where industry was very short of materials, energy, spares etc., a number of cadres have shown a strong tendency to run after profits and the market... Many bad methods continue and in some places things have deteriorated to dangerous levels – such as the use of various ruses, such as avoiding adequate deliveries of products to the state, not paying state incomes to the state, freely setting up bonus and 'bringing-on' systems in the unit, unprincipled increase in cost prices, violation of basic socialist economic management regulations. ... To stop all this, it is necessary... to implement 146-HDBT".

⁵⁴ The title in Vietnamese is *Nghị quyết số 156-HĐBT về một số vấn đề cải tiến quản lý công nghiệp quốc doanh*.

Nonetheless, the basic idea of ‘three plan’ still remained. The SOE could retain output produced from own-procured resources but this had to be approved by its superior as part of the plan. Through the two conservative legislation of the government, it showed that “policy was conservative at a time when the basis for a commercialised state industry was being created, and point to major underlying political conflicts” (Fforde 2007: 23).

In contrast to the conservative movement between 1982 and 1984, Resolution No. 306-BCT “On ensuring the autonomy in production and trade of basic economic units”⁵⁵, issued as a draft form in April 1986 aimed to increase the autonomy of SOEs. This was not a sudden U-turn but an urgent response to serious macroeconomic instability caused by the failed ‘price, salary and currency’ reform in 1985.

Price, Salary and Currency reform in 1985

The economic condition became difficult again from 1984. The two-price system kept creating shortages of necessary products and high inflation persisted.⁵⁶ The authorities reacted with ‘prices, salaries and currency’ reform in June 1985. The Eighth Plenum (the Fifth National Congress) decided to abolish the subsidised and bureaucratised economy and move towards a cost account based economy. The breakthrough of the Eighth Plenum was the abandonment of subsidisation. It proposed that rationing should be abolished altogether, prices increased to market levels (and allowed to remain there) and a subsidy paid to wages in order to compensate workers for the price increases. It introduced the adjustment of price levels, cash payment of salaries and the inclusion of reasonable expenses in the cost-price of the products (Nguyen Thi Hien 2008).

⁵⁵ In Vietnamese, *Nghị quyết (dự thảo) số 306-BCT về bảo đảm quyền tự chủ sản xuất, kinh doanh của các đơn vị kinh tế cơ sở*.

⁵⁶ It was said that the consumer price index(CPI) grew 448 per cent over the period 1982-1983 and 759 per cent over 1983-1984 apiece (Nguyen Thi Hien 2008: 272).

However, in contrast to the prediction, the result of those policies was miserable. It was apparently still not acceptable to the majority to switch to the market mechanism, so the new prices remained administered prices. In order to distribute the new prices to the trade organizations, 30 tonnes of paper had to be printed and transported to the various regional units. The organisations had to wait until they received these new prices before they could begin selling, with the result that inflationary pressure in free markets increased and the gap between new state prices and market prices expanded rapidly (Beresford and Fforde 1997: 123).

The budget revenue was far behind the soaring budget expenditure required by the reform measures. Pressure from the southern provinces, where the standard of living was much higher than in the north, ensured that wages in fact more than doubled. The government faced incredibly high demand for money during the implementation of the new policy because the ‘prices, salaries and currency’ reform was designed to change the economy into a monetised economy.

This also made the operation of SOEs very difficult because they had to purchase input material at market prices which were far higher than the state prices. SOEs representatives argued that the SOEs could not survive if they were forced to purchase inputs at market prices since they would not be able to sell their products, even at cost price. Indeed, after subsidized input prices were finally abolished in 1989, many SOEs were forced to close down their operations, and this provided fuel for arguments against further hardening of SOE budget constraints. The result of their argument in 1985, however, was that state-subsidized inputs would continue to be supplied to SOEs at 70 per cent of the market-price level. Pressure from these two groups, plus the unwillingness of the leadership to abolish the system of administered prices, ensured that the inflationary spiral intensified after the reform (Beresford and Fforde 1997: 124).

The government had to print more money to cover the budget deficit, which aggravated the situation. The vicious cycle of inflation appeared to be unstoppable. The inflation rate recorded a high of 875 per cent in 1986. The hyperinflation lasted until the Sixth Plenum (the Sixth National Congress) decided to carry out the one-price system based on market prices in 1989. Average monthly inflation rates were 2.6 per cent in 1989 and 4.5 per cent in 1990 compared to 19.9 per cent in 1986 and 14.5 per cent in 1988 (Do Hoai Nam 1994: 117-8).

U-turn to a reformist move: Resolution No. 306-BCT

It was said that the purpose of the resolution was “to eliminate entirely the centralised bureaucratic structure of management and subsidies and to effect the materialisation of a democratic centralism, economic self-accountancy and socialist business” (*Nhan dan*, 23 April 1986, reporting a speech by Vo Chi Cong, the secretary of the Central Committee of the party, quoted in Jerve *et al.* 2002: 210). The resolution established the central role of the SOE director, affirming the director’s power to take independent decisions with regard to the management of the enterprise. It stated that

306-BBT⁵⁷ was a re-loosening as far as the SOEs were concerned. ...
Confronted with a situation where the country was close to collapse
and the people were deeply unsettled, the state had to continue with
loosening up through 306-BBT. (Fforde 2007: 188)

Decision No. 76-HDBT, promulgated in 1986, “On the promulgation of temporary rules ensuring the autonomy in production and trade of basic economic units”, was an

⁵⁷ Fforde recognises that the issuing organ of Resolution No. 306 was the Secretariat of the CPV which is abbreviated to BBT (*Ban Bí thư*) and wrote the number of legislation as “306-BBT” but many other sources identify the Politburo, abbreviated BCT (*Bộ Chính trị*) as the issuing organ of this resolution and generally written as Resolution No. 306-BTC. Both Resolution 306-BBT and 306-BCT refer the same legislation.

implementation document for Resolution No. 306-BCT of the party.⁵⁸ It contained nine regulations over the basic business activities of state firms, such as autonomy in planning, financing, pricing, sales and services, signing and implementing economic contracts and the management of the banking system to ensure the autonomy of basic economic units.

Both 306-BCT and 76-HDBT were strengthening the autonomy of SOEs just before *doi moi* was declared in December 1986, which we can interpret as the leadership was forced to take action to cope with growing discontent over the worsening economy associated with the central planning system. The leadership rightly feared that the CPV could be damaged. This may be why the party Resolution No. 306-BCT was announced quickly in a draft form and further reform, *doi moi*, was on its way.

Enhanced autonomy to SOEs: Decision No. 217-HDBT

After the declaration of *doi moi* in December 1986, more autonomy was given to SOEs through Decision No. 217-HDBT which was *politically* supported by central organs, such as the Ministry of Labour, the Ministry of Foreign Trade, the Ministry of Finance and the State Bank of Vietnam followed (Fforde 2007: 199). It, issued on 14 November 1987, was titled to “Promulgate reform policies for socialist business planning and accounting in SOEs”.⁵⁹ Decision No. 217 was the extended version of the Government Decision No. 25-CP in 1980 by which the ‘three part system’ was introduced. State enterprises now were able to take the initiative in preparing and implementing long term and short term plans for their production and business activities.

According to Decision No. 217-HDBT, produced goods were grouped into three categories and ‘three legal targets’ were assigned to enterprises along with the product

⁵⁸ Fforde argues that the implementation decree did not follow the reformist intention of the resolution of the CPV. See Fforde (2007: 186-188) for further discussion.

⁵⁹ The title in Vietnamese is *Quyết định số 217-HĐBT, về các chính sách đổi mới kế hoạch hóa và hạch toán kinh doanh xã hội chủ nghĩa đối với xí nghiệp quốc doanh*.

category. For products defined as primary and whose materials were supplied under state guarantee, enterprises had to fulfil the target of the quantity and quality of the products, the value of commodity production and the budgetary contribution to the state, that is, three legal targets. For products which did not fall under the list of primary goods whose materials were partially supplied by the state, enterprises were assigned to fulfil only the latter two targets – the value of the commodity and the contributions to the state. Finally, for production and repair services, if enterprises mainly used self-procured materials, they were required to fulfil only one target, that is, the contribution to the state. The autonomy of enterprises in the production plan as well as in recruitment was allowed and there would be a shift from the system of state organisation of employment to a system of labour contracts.

The aim of this Decision was to create a new economic management system. As a result, the basis of planning became the firms' plan rather than what their governing organs sent to the firms. It abolished direct budgetary support (Fforde and de Vylder 1996, Van Arkadie and Mallon 2003). Mandatory targets were reduced to no more than three. Any plan issued to SOEs was related directly to the ability of the state to supply the inputs to those enterprises. Furthermore, SOEs were granted 100 per cent of basic depreciation and full rights over their capital, including retained profits.

Subsequently Decree No. 50-HDBT, promulgated on 22 March 1988, on “Regulations for state industrial enterprises”⁶⁰ provided more details on the rights and responsibilities of SOEs. A wide range of autonomy in business operation was granted with some restrictions. For example, selling of assets (even if these had become surplus to requirement) and changes in allocated plans still required the approval of superior organs. However, directors could appoint deputy directors and the chief accountant with the

⁶⁰ The title in Vietnamese is *Nghị định số 50-HĐBT về điều lệ xí nghiệp công nghiệp quốc doanh*.

agreement of superior organs and wages were to be paid by the wage funds accumulated by individual SOEs (Communist Party of Viet Nam 1991: 39-47). Decision No. 195-HDBT formally abolished the two-price system in December 1989 by amending 217-HDBT.⁶¹ The control over prices was largely removed. Non-price controlled products were priced based on the bargaining between buyers and firms. For price-controlled products, the price was set by the enterprise with reference to a price committee (Vu Quoc Ngu 2002: 7). The number of goods controlled by the price committee was reduced from 100 in 1987 to 8 in 1990 (Le Dang Doanh 1996: 65). The transitional model was over and central planning was effectively ended (Beresford and Dang Phong 2000, Fforde 2007).⁶²

The autonomy granted to SOEs by Decision No. 217-HDBT was somewhat modified several times in a way to strengthen the state control over SOEs again. For example, Decision No. 93-HDBT, promulgated on 24 July 1989⁶³, changed the system of basic depreciation of state economic units by amending 217-HDBT and 50-HDBT. As examined, SOEs were granted to keep 100 per cent of their basic depreciation through Decision No. 217. However, Decision No. 93-HDBT reduced the amount of retainable basic depreciation to seventy per cent for new projects for three years, which means the state was able to increase its budget revenue by an equivalent amount.

⁶¹ Decision No. 195-HDBT, promulgated on 2 December 1989, was titled “Supplementing Decision No. 217-HDBT on business activities of SOEs” (*Quyết định bổ sung Quyết định số 217-HĐBT về việc hoạt động của các xí nghiệp quốc doanh*).

⁶² The pace of change in the Vietnamese economy after 1989 was extraordinary. Light manufacturing output increased, garments and footwear in particular, contributing to the export boom. Foreign direct investment rose steadily. Vietnam experienced strong economic growth combined with macroeconomic stability into the late 1990s (Van Arkadie and Mallon 2003).

⁶³ In Vietnamese, *Quyết định số 93-HĐBT, sửa đổi chế độ nộp khấu hao cơ bản của các đơn vị xí nghiệp kinh tế quốc doanh*.

Meanwhile, Decision No. 143-HDBT, promulgated on 10 May 1990, summarised the implementation of 217-HDBT, 50-HDBT and 98-HDBT.⁶⁴ It stipulated the installation of a Council of Management (*Hội đồng quản trị*) as part of the management apparatus (*bo máy quản lý*) of a state firm. One half of the members of the Council of Management were to be appointed by the directly superior state organ. The appointees could be representatives of the directly superior state organ sitting on behalf of the Chairman of the Council or an expert in finance appointed by the finance organ. The other half of the Council members was to be composed of insiders and workers. This reduced the autonomy of SOE directors because outsider members were appointed by the superior organs, showing the strong desire to regain influence over SOEs (Fforde 2007: 208).

In addition, Decree No. 217-HDBT permitted lower levels of government to establish SOEs. The result was an explosion of small, often district-level state firms. It is impossible to determine the degree to which these firms engaged in arbitrage opportunities, but many of them did report losses and constituted a significant drain on the state budget (Painter 2003a, b, 2008, Porter 1993, Van Arkadie and Mallon 2003).

Most of the loss making SOEs that drained state resources and contributed little to state budget revenues were smaller SOEs attached to departments of line ministries or lower levels of government over which the central government had little control. Transforming smaller SOEs was an attempt to improve economic performance and also a means through which the central government could break the power of

⁶⁴ The full title of Decision 143-HDBT was “summarising the implementation of Decision 217-HDBT and Decree No. 50-HDBT and 98-HDBT on reforming the management in SOEs and continuous piloting reform of the management in SOEs” (*Quyết định số 143-HĐBT, tổng kết thực hiện Quyết định 217-HĐBT, các Nghị định 50-HĐBT và 98-HĐBT về đổi mới quản lý xí nghiệp quốc doanh và làm thủ việc tiếp tục đổi mới quản lý xí nghiệp quốc doanh*). The Decree No. 98-HDBT, promulgated on 2 June 1988, was on “a ownership right of collective labour in SOEs” (*về quyền làm chủ của tập thể lao động tại xí nghiệp quốc doanh*).

lower levels of government that had used smaller SOEs as tools for asset stripping and rent distribution (Cheshier *et al.* 2006: 6)

The increase in loss-making SOEs caught the attention of the state in the early 1990s and it promulgated Decree No. 388-HDBT⁶⁵ in November 1991 to restructure SOEs by forcing them to apply for new operating licences, with re-registration approval predicated on business viability (Cheshier 2010: 123, Vu Quoc Ngu 2002) and roughly 3,000 SOEs were liquidated and 2,000 merged into other SOEs (Cheshier *et al.* 2006: 7).

Summary: Were the budget constraints on SOE soft?

The relations between the state and SOEs during the period 1976-90 can be summarised as the initial centralisation followed by decentralisation and then recentralisation in terms of the autonomy SOEs were granted. These swings were largely affected by the economic situation and corresponding reactions of the CPV leadership and the state. Economic hardship combined with poorly managed economic planning *forced* SOEs into engaging ‘fence-breaking’ in order to either seek required cash incomes or mobilise required input for main production lines which should have been allocated by the state. The CPV leadership who at first were stubbornly refused to endorse these diversions had to admit them, and declared that there were errors in the implementation of socialist economic plan at the Sixth National Congress of the CPV in December 1986.

How do we interpret fence-breaking in terms of budget constraints? Fence-breaking has largely been understood as a breakthrough experiment initiated by a local leadership to cope with economic difficulties through the reliance on ‘market mechanisms’ (Beresford and Dang Phong 2000, Fforde 2007, Rama 2008, Tran Dang 1994). The root cause of fence-breaking was “the chronic shortages of materials, power and fuels” (Dam Van

⁶⁵ It was promulgated on 20 November 1991 whose title was “Establishing and liquidating SOEs” (*Nghị định số 388-HĐBT Quy chế về thành lập và giải thể doanh nghiệp nhà nước*).

Nhue and Le Si Thiep, 1981: 24, recited in Fforde 2007: 132). Consequently, SOEs had been ‘turned loose’ and had to fend for themselves. While we do not have direct research on the matter of soft budget constraints on SOEs during the period 1976-1990, it would not be an exaggeration to conjecture that SOEs which were forced to do fence-breaking activities faced harsh budget constraints.

Another fact supporting that SOEs did not face soft budget constraints over the same period is the transformation of the role of SOEs from production units to a tax base. The state which chronically suffered from a weak tax base rediscovered the role of SOEs as an important tax base for the regime rather than production units in the decentralisation move which was ignited by No. 25-CP in 1981 and No. 215-HDBT in 1987 (Fforde 2007). The transformation of the function of SOEs from a production unit to a tax base made the state seize the control over SOEs to establish financing to the state, which resulted in the recentralisation move from 1982-1985 and 1988-1991. It seemed not easy for the state to let go this important tax base and source of national development projects.⁶⁶

There was the issue of granting ‘autonomy’ to SOEs in order to resolve the matter of productivity at the centre of the SOEs reform in this period while the issue of changing the type of ownership kept intact. From the 1990s to present, the structure of SOEs and the type of ownership is at the centre of discourses on reforming SOEs, which is likely to cause a change in budget constraints.

⁶⁶ Those swings between centralisation and decentralisation do not necessarily mean one party gains power over the other. For example, SOEs can make a deal like as ‘we pay tax and do not touch us’ with the state. This is a likely outcome given that Vietnam has not had a competent Weberian bureaucracy.

2.3. Reform policies since 1990s

Background

In 1990 a Company Law was promulgated, providing a legal framework for private firms. The Law on Foreign Investment, originally issued in 1987, was amended in 1990 and 1992. In 1992 the Constitution was amended, recognising a role for the private sector in the Vietnamese economy. In 1993 a Land Law and Bankruptcy Law were promulgated. That year also saw the return of the World Bank and International Monetary Fund (IMF) to Vietnam. In 1994 the U.S. trade embargo was lifted and relations with the United States were normalized in 1995. In 1995 Vietnam joined the Association of Southeast Asian Nations (ASEAN) and the Asia Pacific Economic Cooperation (APEC). The turnaround from international isolation and looming macroeconomic collapse in 1989 was remarkable (Cheshier 2010: 118-9).

The environment continued to improve in the 2000s. In 2000 the first stock market opened in Ho Chi Minh City. Vietnam also signed the United States Bilateral Trade Agreement (USBTA) and the U.S. quickly became one of Vietnam's top trading partners. In 2003 a revised Land Law was promulgated, along with a revised Law on State Enterprises. In 2005 a new Enterprise Law and a new Investment Law were issued, unifying the legal framework for domestic private and foreign enterprises, and governing the operations of transformed state enterprises. These laws took effect in July 2006. In 2006 the formal domestic private share of industrial output for the first time was equal to that of the state sector. In January 2007, Vietnam joined the World Trade Organization (WTO) (*ibid.*: 139-40).

Ironically the effective end of central planning in 1989 and movements towards a market economy in the early 1990s did not bring 'hard' budget constraints contrary to conventional wisdom that the introduction of market mechanisms are likely to harden

budget constraints on SOEs (Boycko *et al.* 1996, Kornai *et al.* 2003). Before *doi moi* all businesses officially belong to the state and they suffered from the shortage of resources including the support from the state budget. The abandoning of central planning combined with ‘unreformed’ politics led to a development strategy which relied on the leading role of SOEs (Beresford and Fforde 1997, Fforde 2007, Riedel and Turley 1999, Van Arkadie and Mallon 2003), which made resource allocation have been centred to the state sector. As a result, the private sector has relatively been treated unfavourably.

It might be controversial to argue that the Vietnamese government has not been supportive of the private sector because it has implemented pro-market economic policies since *doi moi*. However, it is very difficult to find policies specifically benefiting the private sector. The pro-market economic policies of the Vietnamese government have been mainly applied to the state sector. The private sector, compared to the pre-*doi moi* period, is still not favoured by the authorities. For example, surveys on business environment in Vietnam conducted by Ronnas and Ramamurthy (2001) and Tenev *et al.* (2003) showed that the private enterprises feel the official’s attitude was not so friendly and the playing field of state enterprises and private enterprises are not levelled. It is said that this atmosphere has not been improved much until recently.⁶⁷ SOEs, especially large ones, are the entities which have benefitted the most from the transition to a market economy in Vietnam.

This politically conservative⁶⁸ but economically reformist approach of Vietnam is called ‘market-Leninism’ (London 2009).⁶⁹ One of the remarkable result is the

⁶⁷ Some private business owners complain that the state still hates or is afraid of the behaviour of making money and getting rich in Vietnam could make themselves at risk.

⁶⁸ There still were a group of people within the party who did not advocate the market mechanism after ten years of *doi moi*. For example, Khong Doan Hoi (1995) said that “even though we have achieved significant economic growth, ‘achieving political stability is not a simple matter. This requires correct understanding and vigilance, particularly in a situation in which the economy is operating based on market mechanisms and the enemy is carrying out a

commercialisation of the state sector which created largely blurred distinction between the state and the private sector (Beresford 2008, Beresford and Dang Phong 2000, Fforde 2007, Gainsborough 2002, 2003b, Herno 1998). The banner of companies largely has no meaning in identifying a state company or a private company. They may be called a state-related private company (Cheshier 2010, Gainsborough 2003c, 2010b), a disguised state company owned privately (Gainsborough 2003b), or a ‘virtual share company’ which “largely treated by their effective owners⁷⁰ as private in nature, and so capable of performing under competitive conditions *without* economically destabilising state support” (Fforde 2007: 214). These blurred property rights in the state sector has created rent switching and resource appropriation over the transition period (Fforde 2002, 2007, 2009, 2010).

It is argued that the Vietnamese conservative politics or unreformed politics has been a drag on further economic reform (Fforde 2011, 2013). In particular, Fforde (2013) raises a question on the capacity of the CPV to serve as the driving force of economic growth. He argues that the role of the CPV is not deriving but following at best over the reform (see also Fforde and de Vylder 1996, Fforde and Paine 1987). The CPV “had not been the key driver of the transition from plan to market. Due to its internal 'structural' institutional practices, major insider interest groups were meant to be able to prevent change that they did not want, limiting the discretionary power of peak leaders” (Fforde 2013: 383).

Consequently, in Vietnam, there has been “no domestic sovereignty” since *doi moi* and in

“peaceful revolution” plot against our country ... but doesn’t the most inclusive factor start from money, from the good and evil of money? ... it will be difficult to maintain political stability in the face of the strength of money ... if money is allowed to do whatever it wants in our country, we will be committing suicide” (FBIS-EAS-95-159, 17 August 1995: 68-9).

⁶⁹ Market-Leninism as one of types of market socialism is defined as “communist parties pursue their political imperatives through market institutions and market-based strategies of accumulation while maintaining Leninist principles and strategies of political organization” (London 2009: 376).

⁷⁰ Fforde suggests ‘state bodies linking the SOE into the state apparatus’ such as the Ministry of Finance and ‘General Companies’ such as General Corporations and State Economic Groups as effective owners (Fforde 2007: 218).

2000s in particular (*ibid.*: 393).⁷¹ A less pessimistic view is found in Dixon (2004) and Gainsborough 2010b: ch. 7). They argue that the development of factions having different interests have direct and indirect inputs into policy formulation and implementation. Hence the enforcement has significantly been interrupted but it has not in chaos.

The murkiness of property rights in Vietnam makes the matter of hardening budget constraints on SOEs more complicated because it is not clear who is the owner controlling the SOE effectively. Without asking who is the real owner of SOEs, changing ownership type from state-owned to privately-owned or applying strict lending rules does not automatically lead to hardening budget constraints (Fforde 2007). This approach coincides with the findings of Gainsborough (2005) and this dissertation that the softness of budget constraints which each individual SOE faces varies widely depending on what connections the SOE director has established.

Return to the relationship between the state and SOEs. As examined Decision No. 143-HDBT in 1990 was the move showing that the state desired to have more influence on SOEs. This tendency continued in the 1990s to 2000s during which equitisation (*co phan hoa*) of SOEs and forming big SOEs such as General Corporations (*tong cong ty*) and State Economic Groups (*Tap doan nha nuoc*) are significant changes.

Equitisation

Equitisation, a type of partial privatisation, means issuing and selling shares to both insiders (the state, directors and employees) and outsiders to turn an SOE into a joint-stock company (JSC). This partial privatisation is not a unique in Vietnam but popular in many developing countries such as Taiwan, Malaysia and Singapore and also in developed countries like the UK, Japan, France and Canada (Boardman and Vining 1989,

⁷¹ Refer to, for example, Thayer (2009), Vasavakul (2003) and Vuving (2010) for the argument that the CPV has established decent domestic sovereignty.

Boubakri *et al.* 2004).⁷² For example, Taiwan started privatising in a serious way only in 1996, relinquishing majority shares in SOEs in banking, insurance, petrochemicals, transportation, and a few other industries. However, Taiwan's privatisation has been a very controlled one, as the government still has a controlling stake (average of 35.5%) and accounts for 60% of board members in the eighteen privatised state-owned enterprises. The Taiwanese government is allowed to own the "golden share" (i.e., the veto over important decisions) when privatizing SOEs in defence or public utilities (Chang 2007: 11).

Equitisation in Vietnam began as a pilot programme under Resolution No. 2-NQ-HNTW⁷³ on 4 December 1991 followed by a number of government decisions such as Decision No. 202-CT, 8 June 1992 and Directive No. 84-TTg, 4 March 1993.⁷⁴ The main purposes of equitisation were to mobilise capital and improve the efficiency of state firms as stated in Decree No. 44 as follows:

Article 2. The transformation of SOEs into joint-stock companies (hereafter referred to as equitisation for short) aims to achieve the following objectives:

1. Mobilising capital from the entire society, including domestic and foreign individuals, economic organisations and social organisations

⁷² Jones *et al.* (1999) found that only 11.5% of the firms sold all of their capital and less than 30% sold more than half of their capital in the initial public offering in a sample of share-issue privatisations from 59 countries.

⁷³ The title of Resolution No. 2-NQ-HNTW issued by the Central Committee (*Ban Chấp hành trung ương*) of the CPV was "on the tasks and solutions to stabilise and develop socio-economy between 1992-1995" (*về nhiệm vụ và giải pháp ổn định, phát triển kinh tế-xã hội trong những năm 1992-1995*).

⁷⁴ Decision No. 202-CT issued by the Prime Minister (*Chủ tịch Hội đồng bộ trưởng*) was titled "on continuous a pilot programme on transforming SOEs into joint-stock companies" (*về việc tiếp tục làm thí điểm chuyển một số doanh nghiệp Nhà nước thành Công ty cổ phần*). Directive No. 84-TTg was titled "on stimulating the implementation of the pilot programme to equitise SOEs and solutions to the issue of various ownership form of SOEs" (*về việc xúc tiến thực hiện thí điểm cổ phần hóa doanh nghiệp Nhà nước và các giải pháp đa dạng hóa hình thức sở hữu đối với các doanh nghiệp Nhà nước*).

for investment in renewing technologies, creating more jobs, developing enterprises, raising the competitiveness and restructuring SOEs.

2. Creating conditions for labourers in enterprises to have shares and for the capital contributors to be the real masters; changing the mode of management to create a motive force for enterprises to enhance their business efficiency, increase the State's assets and the labourers' incomes and thus contributing to the national economic growth.

(Decree No. 44/1998/ND-CP⁷⁵, promulgated on 29 June 1998)

The equitisation began with the voluntarism and the number of SOEs turned into the form of JSCs reached only seventeen between 1992 and 1998. In 1996 the government issued Decree No. 28-CP to end the voluntarism and allocated the task of equitisation to relevant ministries and authorities in all localities. This decision was followed up in more detailed instructions in Decree No. 44/ND-CP in 1998 which led to the increase in the number of equitised SOEs. More than two thousand firms were equitised between 2001 and 2005 (Cheshier *et al.* 2006: 6).

It is not clear why the Vietnamese state initiated equitisation given that SOEs activities were growth-enhancing rather than growth-hampering. Fforde (2007, 2009, 2010) called this 'Vietnam paradox' in which macroeconomic stability combined with the dominating state sector, which is contrary to conventional arguments of mainstream neoclassical economics. The paradox is closely related to the role of SOEs as a tax base which we examined earlier – instead of aggravating the state budget, they contributed to it.

The state enterprise reform in Vietnam aimed to change the ownership of state firms but equitisation created an interesting hybrid that was neither state nor private. In particular, employees had the priority in buying the shares that were available for private purchase.

⁷⁵ The title of Decree No. 44/1998/ND-CP was “on transforming SOEs into joint-stock companies” (*về việc chuyển doanh nghiệp Nhà nước thành Công ty cổ phần*).

It is said the priority given to employees is a product of the realisation of ‘communist ideology’ that workers (the proletariat) hold ownership of firm.⁷⁶

Multilateral organisations criticised the reform on the grounds that equitisation changed the state firm into a joint-stock company by creating and selling shares but the state generally holds on to fifty-one per cent of shares of the equitised SOE in order to act as a majority shareholder. Even this progressed quite slowly. Why? Was it because the government intentionally deter equitisation?

Although there a limited number of equitised SOEs in the sample, this dissertation finds from the interview that SOEs experienced a different set of difficulties with the equitisation programme. These difficulties can be summarised under three heads. Firstly, progress with equitisation required the decisions of higher level authorities. Every single equitisation process was under the direct control of the Prime Minister and entirely depended upon his decision. This does not mean that the SOE would be equitised reports directly to the Prime Minister. There are quite complicated overlaps in decision-makings in Vietnam.⁷⁷

Secondly, it is because no evident results were revealed regarding the greater efficiency of state firms undergoing equitisation. Our interviews contained mixed opinions regarding the efficacy of equitisation. Interestingly, an empirical analysis of Vietnam’s equitised SOEs argued that profitability, efficiency, real sales, and employee income

⁷⁶ This is quoted from the speech of Dr. Le Dang Doanh, a well-known Vietnamese economist, which was delivered at one of EuroCham Hanoi Luncheon meetings in 2013. Hiebert gives a story of one the earliest privatisation as follows: “Some 42 percent of the company’s shares were purchased by the firm’s employees, 18 percent were retained by the ministry, and the rest were sold to ministry staff. No shares were left for sale to the general public” (Hiebert 1996: 70-1).

⁷⁷ For an extensive analysis of the decision making process in Vietnam, see Dang Phong and Beresford (1998).

increased significantly after equitisation (Truong *et al.* 2004). However, when we conducted interviews in 2005, firm-level responses were mixed, with some firms unsure about the results of the process; others answering that efficiency had slightly improved. But it should be noted that they were equitised just for a couple of years at the time of the interview.

Finally, there was an issue of redundant labour emerging as a result of the equitisation, which was a great burden to directors of state firms because many of them considered that providing stable jobs to workers and keeping them employed were their priorities (Besler and Rama 2001). A manager of an equitised central SOE (Firm P)⁷⁸ said that:

They are officially state employees. Equitisation, together with the restructuring of production processes created redundant workers. (L)abourers do not want to receive the lump sum retirement allowance because they still want to stay (as employees). However, many of them will not be able to stay on. We can say that the employees being state employees think that everything is being sponsored by the state. Now, with equitisation they risk losing their rights to employment. We have to communicate and talk to the state about this issue. Decree 41⁷⁹ only applies to firms which change their ownership type before the end of 2005. So, we hope the interview team could influence the government of the Socialist Republic of Vietnam to extend Decree 41 for the employees in SOEs (to enable them to retain their jobs).

However, not all of them had the same response. Another firm argues that their employees were happy to get a lump sum retirement allowance and employees' shares

⁷⁸ Firm initial is from the interview. See Table 23 (p. 171) for the summary of interviewed firms.

⁷⁹ Decree No. 41 refers No. 41/2002/ND-CP promulgated on 11 April 2002. Its title was “on policies for redundant labourers resulting from SOEs restructuring” (*về chính sách đối với lao động dôi dư do sắp xếp lại doanh nghiệp Nhà nước*).

when they retire because it was a huge amount of money. The director of an equitised local SOE (Firm G) said

Those who have to retire according to Decree No. 41 are the labourers who have devoted enough time but have not reached the age of retirement. They are waiting for retirement. The state fills up the loss for the remaining years of employment with a sum of money according to the Decree. They calculate that there would be greater benefits if they voluntarily leave according to the Decree. When they reach the age of fifty-five they are still treated as a pensioner. In addition, when they leave the company, they are given forty-seventy million Vietnamese dong (equivalent to USD 2,500 – 4,380).⁸⁰ So they are willing to leave (because) they had never had such a big sum of money. In addition, they are eligible for buying the shares of the company. In other words, they can become shareholders at preferential prices. The incentive here means that when the shares are for sale the prices offered to them are forty per cent discounted.

The pace of equitisation speeded up since 1997. In 1998 alone, over 100 , in 1999 around 250 and in 2000 around 210 SOEs were equitised (Cheshier *et al.* 2006: 8) and also two years of tax break were provided as an incentive. The changes in government regulations do not explain all of this ‘speedy’ equitisation in the 1990s.

There are few insightful analyses attempted to explain why the equitisation proceeded so *slowly* until the late 1990s. Just seventeen state firms were equitised between 1992 and 1998. Gainsborough (2003a: 50) argues that a “key one (reason) was an unwillingness on the part of political and business interests associated with SOEs to do anything which would remove them from what they regarded as the ‘best space’ for doing business.” It is believed by the stakeholders of SOEs – such as managers, directors and workers – that

⁸⁰ GDP per capita in 2005 was USD 620 according to the *World Development Indicator*.

“remaining in the state sector afforded a company the best chance of receiving state budget support, accessing other forms of protection, or avoiding the discrimination faced by private firms in obtaining bank credit, land use rights, licenses or contracts” (Gainsborough 2003a: 51). During the Asian financial crisis of 1997-8 and the followed state budget tightening or hard budget constraints made agents such as “enterprise managers, their controlling institutions and labour forces all recongize that in the absence of budget subsidies and cheap bank credit and amid dwindling levels of protection, there are now fewer advantages to be had from remaining in the state sector” (Gainsborough *ibid.*: 54; and also Fforde (2004: 45-7).

On the other hand, state big businesses have remained in the state sector because they have not had any choice since the “government wants to keep them in public hands”⁸¹ (Gainsborough 2003a: 54). Similarly it is argued that the equitisation has shown the bifurcation between the small sized (and locally managed in general) firms and large sized (and centrally managed in general) ones. The government has aimed to release the small-sized firms from state control but it has not meant any relinquishment of state control over the large-size firms Cheshier *et al.* (2006).

General Corporations and State Economic Groups

Together with equitisation, the Vietnamese state has implemented a set of policy to form big business groups via the General Corporation programme and State Economic Groups (SEG) programme.⁸² The basic thrust of this approach is to transform all SOEs into firms

⁸¹ It is argued that equitisation does not necessarily mean the retreat of the presence of the state in Vietnam because even after the equitisation the state in many cases still remains as a controlling shareholder and it still sends its presentative in the supervisory board of equitised SOEs. Hence the equitisation in Vietnam might be understood as the state ‘advance’ (Gainsborough 2009a).

⁸² In contrast to a group of scholars emphasising the important role of town-village owned enterprise (TVEs) in Chinese economic growth, some scholars pay attention to the contribution of big businesses to the economic growth in China. Nolan and Zhang (2002), for

operating under the Enterprise Law by 2010. Strategic sectors have been designated as part of a commanding heights strategy, in which the state will retain full (100 percent) or majority (over 50 percent) ownership in large SOEs operating in these sectors. SOEs not operating in these sectors are to be released: equitised, transformed into limited liability companies or closed down (Cheshier 2010: 140).

There are two types of General Corporations which are named GC-90 and GC-91 because they were established under Decision No. 90 and Decision No. 91 of the Prime Minister promulgated on 7 March 1994.⁸³ The government established General Corporations in several strategic industrial sectors, such as (i) post, telecommunication and information technology, (ii) ship building and maintenance, (iii) generating, transmitting and distributing electricity, (iv) exploring, processing, and distributing gas and oil, (v) surveying, exploring, and processing coal and other minerals, (vi) garment and textiles, (vii) rubber planting and processing, (viii) fertilizer and other chemicals manufacturing, (ix) real estate investment, (x) construction and mechanics, (xi) finance, banking and insurance, (xii) other sectors in accordance with the decision of the Prime Minister.

The General Corporation programme initially aimed at increasing efficiency and international competitiveness of SOEs. The Vietnamese government tries to achieve this

examples, argued that large SOEs were not the object of clearance from the very beginning of the economic reform in China and the Chinese government intentionally support and make grow large state firms, particularly in strategic industries, such as aerospace, oil and petrochemicals, pharmaceuticals, power equipment and telecommunications. The introduction of contract system in China turned large SOEs towards profit seeking which led to increase the size of retained earnings and production capacity (Jefferson and Rawski 1994). As a result, many fast-growing and fast-modernising large state firms emerged under the contract system along with the reduction of soft budget constraints (Nolan and Wang 1998).

⁸³ Decision No. 90-TTg was titled “on continuous SOEs restructuring” (*về việc tiếp tục sắp xếp doanh nghiệp Nhà nước*) and Decision No. 91-TTg was titled “on the pilot programme to set up business groups” (*về việc thí điểm thành lập tập đoàn kinh doanh*).

goal by increasing the size of SOEs (World Bank 2012).⁸⁴ Following this, the Prime Minister Directive No. 11/2004/CT-TTg in 2004 signalled a policy change and accelerated equitisation of General Corporations followed by Decree No. 153/2004/ND-CP in 2004 on the conversion of General Corporations into holding companies, which known as the ‘mother company-children companies (*cong ty me – cong ty con*)’ format.⁸⁵

A holding company here does not mean large entities involved in a wide variety of industries. Instead, it refers to corporatisation of entities whose activities are largely restricted to one sector. The holding company can then exercise management control over its subsidiary companies which was not allowed in the General Corporations scheme. This policy created SEGs. As of 2013, there are eleven state economic groups established by the Prime Minister. Economic groups are comprised of legally independent companies forming a mother-subsidary relationship. The group itself does not have a legal identity and therefore does not register under the Enterprise Law. In general, the mother companies of economic groups were established under the State-owned Enterprises Law of 2003 and their equity is 100 per cent held by the government (Kim et al. 2010: 3-4).

⁸⁴ It is frequently mentioned that the Vietnamese government referred to the model of Korean *chaebols* which developed under entirely different situation from that of Vietnam.

⁸⁵ The Prime Minister Directive No. 11/2004/CT-TTg, promulgated on 30 March 2004, was titled “Strengthening arrangement and reform of SOEs following the spirit of decrees of the Third and the Ninth Plenum of the party (the Ninth National Congress of the CPV) and organising the implementation of the State Enterprise Law” (*đẩy mạnh sắp xếp, đổi mới doanh nghiệp Nhà nước theo tinh thần Nghị quyết Trung ương 3, Nghị quyết Trung ương 9 (Khóa IX) và tổ chức triển khai thực hiện Luật Doanh nghiệp Nhà nước*). The government Decree No. 153/2004/NĐ-CP, promulgated on 9 August 2004, was titled “Organising and managing General Corporations and transforming General Corporations and independent SOEs following the model of mother-children company” (*về tổ chức, quản lý Tổng Công ty Nhà nước và chuyển đổi Tổng Công ty Nhà nước, công ty Nhà nước độc lập theo mô hình Công ty mẹ - Công ty con*).

Table 4: Forming state big businesses⁸⁶

Regulation	Main Contents
Seventh National Congress of the CPV (1991)	"... to arrange enterprise group in consistent manner with production and business requirements of the new market mechanism ... to build some big companies and enterprises with sufficient prestige and competitiveness to participate in international economic relations."
Decisions 91 and 94 of the Prime Minister (1994)	<ul style="list-style-type: none"> • Eighteen General Corporations, so-called GC- 91, were established. • Aimed at reducing "the power of line agencies to interfere in business management and capture profits and rents of SOEs."
Eighth National Congress of the CPV (1996)	"To make a summary on state general corporations model, thereby, to build measures for developing general corporations as strong economic groups with good performance, high competitiveness, and acting as the backbone of the national economy ..."
Third Plenum of the CPV (the Ninth National Congress of the CPV, 2001)	"... forming some strong economic groups consisting of state general corporations and others economic sectors, involving a multi-business model, in which a core business is defined for specialization, and the group plays dominating role in the national economy, holding large-scale capital, ... establishing, on a pilot basis, some economic groups in some industries, which will have significant advantages, and are of development capacity for international competitiveness and integration...."
Establishment of pilot State Economic Groups ⁸⁷	<ul style="list-style-type: none"> • 2005: Vietnam Post and Telecommunications (VNPT), Vietnam National Coal-Mineral Industries (Vinacomin), and Vietnam National Textile and Garment (Vinatex). • 2006: PetroVietnam, Vietnam Electricity, Vietnam Shipbuilding Industry⁸⁸, Vietnam Rubber. • 2007: Baoviet.⁸⁹ • 2009: Vietnam National Chemical, Industrial Construction (Vinachem). • 2010: Vietnam Housing and Urban Development (HUD).

Adopted from (World Bank 2012: 36).

⁸⁶ See Table A1 (page 236) in Appendix for the list of GC 91 and SEGs.

⁸⁷ Two additional SEGs, Viettel Group and Vietnam National Petroleum Group (Petrolimex), were formed in 2011.

⁸⁸ Vietnam Shipbuilding Industry (Vinashin) was collapsed in 2012 and restructured to form the Shipbuilding Industry Corporation (SBIC) in 2013. See Appendix for the full list of GC-91 and SEGs.

⁸⁹ Baoviet is the only SEC which is equitised as of 2014.

The big businesses programme, however, has not achieved what the state expected in terms of efficiency and international competitiveness. For example, during the period of 1995 and 1997, Vietnam recorded an average of 8.8 per cent growth per year and invested an average of 27.8 per cent of GDP. Changing into a unit comparison, it required about 3.2 units of investment to create one unit of growth. From 2000 to 2002, it consumed 4.5 investment units to produce one unit of growth. Probably the higher unit consumption is able to be explained partly by the fact that the SOEs are involved into heavy industry which requires large capital input. Nevertheless, it cannot be denied that the state sector has factors explaining the inefficient operation (Dapice 2003).

Harvard Kennedy School (2008) criticises that state investment was extremely inefficient reflected in Incremental Capital-Output Ratios (ICOR) above regional comparator countries at similar stages of development as stated in Table 5 below.⁹⁰

Table 5: Regional ICOR comparison

	Period	GDP Growth (% per year)	Gross Investment/GDP (% per year)	ICOR
South Korea	1961-80	7.9	23.3	3.0
Taiwan	1961-80	9.7	26.2	2.7
Indonesia	1981-95	6.9	25.7	3.7
Malaysia	1981-95	7.2	32.9	4.6
Thailand	1981-95	8.1	33.3	4.1
China	2001-06	9.7	38.8	4.0
Vietnam	2001-06	7.6	33.5	4.4

Adopted from (Harvard Kennedy School 2008: 38, Table 3)

⁹⁰ We have to be careful in interpreting ICOR because it is based on the measure on average instead of on marginal. Hence it may mislead to draw a conclusion on the resource allocation. See World Bank (2008: 7) for more explanation.

Instead the cumbersome governance structure allowed many enterprises to behave in irresponsible ways. Many SOEs moved away from their main business operations and shifted to other business interests and products. The most commonly observed example was a shift from production to trading activities, transport and tourism services, or setting up sales counters as a means to create jobs and generate income. Some of those state firms with relatively large capital bases have shifted their investment into restaurants, hotels and other service businesses. For example,

“SOEs in financial difficulties have sold their fixed capital such as machinery and equipment for cash in order to meet short-term working capital requirements. Others have leased out their land, at low rates, to employees, so that the latter can eke out a living independent of the companies, or even sold the land to other individuals and firms for a profit. ... Many state retail commercial centres, transport companies and tourism firms are state business entities in name only with private persons operating the businesses, having rented the premises, equipment, facilities and even the legal status of state firms. These are misuses of state assets for the parochial benefit of certain units or groups of people” (Nguyen Ngoc Tuan *et al.* 1996: 24).

The diversification of SOEs into non-related business areas has attracted criticism from the public on the grounds that the corporate governance of state firms remains limited and competitiveness is low, it would be better for them to concentrate on their main business fields. The state responded with a regulation limiting the maximum amount of capital the state firms could invest in non-related business fields. According to Decree No. 09/2009/ND-CP on “financial management of state companies and management of state

capital invested in other enterprises”, promulgated on 5 February 2009⁹¹, SOEs can invest no more than thirty per cent of their total investment capital in non-related fields. When SOEs invest in the banking, insurance and securities sector, the investment can be no greater than twenty per cent of the capital of the institutions that receive the capital contribution from the SOEs.

SOEs, however, resisted these limitations because their diversification into non-related business fields was driven by their priority to make profits regardless of the fields they engaged in. For example, the Vietnam Post and Telecommunication Group (VNPT) invested in the Maritime Bank. As a state economic group, the VNPT has been requested to withdraw part of its investment capital to reduce the share of the VNPT in this bank. As a result, the VNPT could not buy more shares from the bank when the bank issued more shares to increase its charter capital and consequently VNPT lost its controlling power in the Board of Directors of the Maritime Bank. According to a representative of the VNPT, it “does not want to withdraw capital from the Maritime Bank, because the investment has been bringing big profits, which are even bigger than the profits made by some subsidiaries of the group” (VietNamNet news, “Policy on restricting investments in non-core fields faces strong opposition”, accessed on 4 November 2011).

Similarly, the Vietnam National Petroleum Group (Petrolimx) invested in a joint venture bank with an Indian company and the Vietnam Cement Corporation contributed capital to set up its finance company with charter capital of VND 600 billion (equivalent to USD 30 million). In addition to profit-seeking, there is a very interesting comment from a representative of the Petrolimex that “in some cases, state firms need to make investment in other enterprises, not to make a profit, but for other purposes”; the other purposes not being mentioned (VietNamNet news, *ibid.*). However, the fact that all three companies

⁹¹ In Vietnamese, *Nghị định số 9/2009/NĐ-CP, Quy chế quản lý tài chính của công ty Nhà nước và quản lý vốn Nhà nước đầu tư vào doanh nghiệp khác.*

referred to have invested in banks suggests what the other purposes hinted at by the representative could be.⁹² The reasons for state firms investing in the banking and finance sector are widely acknowledged in Vietnam: to mobilise capital for the holding company. As can be inferred from the case of the VNPT, the controlling power in the Board of Directors can critically influence the business operations of financial institutions, which is most likely to include the main business of banks – lending.

The investments in the banking sector by SOEs can be interpreted as a response to hard budget constraints imposed by the state. The state has hardened the budget constraints faced by enterprises by strictly enforcing tax rules, reducing state budget support and tightening the lending conditions for state firms since the mid-1990s and these constraints became even more effective from the mid-2000s. Consequently, state firms had to find alternative sources for capital mobilisation and their investments in the banking sector have to be seen in this perspective.

However, this strategy can be a potential threat to macroeconomic stability because the financial supervisory authorities lack devices to check the viability of the banks controlled by holding companies. Information on the soundness of the Vietnamese banking sector released in 2011 and 2012 suggests reasons to be worried about the stability of the Vietnamese banking system. The share of non-performing loans in the banking sector has reached 8.4 per cent as of March 2012, the debt-to-equity ratio of the state firms averaged 307 per cent and the total liabilities of SOEs exceed the government's own debts (World Bank 2012).

⁹² Electricity of Vietnam (EVN) invested in the HDBank; the Vietnam Chemical Group (Vinachem) in Vietnam Commercial and Industrial Securities Company (VICS) and Vietnam Chemical Finance JS Company; and Song Da Group in Vietnam Investment Fund and Vietcombank Member Fund. For more detail information, refer VietNamNet news ““Big cheeses” struggle to withdraw capital” (<http://english.vietnamnet.vn/en/special-report/19984/-big-cheeses--struggle-to-withdraw-capital.html>, accessed on 28 March 2012).

The most update reform as of writing this dissertation is Decree No. 69/2014/ND-CP, promulgated on 15 July 2014, on “establishment, re-arrangement and operation of SEGs and General Corporations”.⁹³ Some important points introduced are i) the group structure of SEGs and General Corporations can only extend to up to three levels including the highest level being the parent company of the SEG or General Corporation, ii) the parent company of an SEG now must have a charter capital of VND 10,000 billion (equivalent to USD 500 million), iii) at least 50% of the subsidiaries within an SEG must operate within its core business and must account for at least 60% of the capital invested by the parent company to all subsidiaries of an SEG and iv) a member of the Members’ Council of the parent company in an SEG or General Corporation must not be leaders within the state organs, political or social organisation or subsidiaries of the parent company.

State Capital Investment Corporation (SCIC)

The state also created the State Capital Investment Corporation (SCIC; *Tong cong ty Dau tu va kinh doanh von nha nuoc*) whose Chairman is the Minister of Finance, to deal with the issue of efficient allocation of state capital. The fund the SCIC operates originated from the Assistance Fund (*Quy ho tro*) for equitised SOEs established in 1999 by the Prime Minister’s Decision No. 177/1999/QD-TTg, whose detailed implementation rule was stipulated by the Ministry of Finance’s Decision No. 95/2000/QD-BTC in 2000.⁹⁴ The SCIC operates at three levels for centrally managed firms, locally managed firms and for firms belonging to General Corporations. By establishing the SCIC in 2005 based on

⁹³ The title in Vietnamese is *Nghị định số 69/2014/NĐ-CP về tập đoàn kinh tế nhà nước và tổng công ty nhà nước*.

⁹⁴ The title of Decision No. 177/1999/QD-TTg, promulgated on 30 August 1999, was “on organising and operating of Assistance Fund for equitised SOEs” (*về tổ chức và hoạt động của Quỹ hỗ trợ sắp xếp và cổ phần hóa doanh nghiệp Nhà nước*) and that of Decision No. 95/2000/QD-BTC by the Minister of Finance, promulgated on 9 June 2000, was “regulating, managing, paying in and using Assistance Fund for equitised SOEs” (*về Quy chế quản lý, thu nộp và sử dụng Quỹ hỗ trợ sắp xếp và cổ phần hóa doanh nghiệp Nhà nước*).

the decision of the Prime Minister (Decision No. 152/2005/QĐ-TTg)⁹⁵, the ownership stakes in many state firms held by the Assistance Fund have been transferred from various line ministries and provincial governments to the SCIC.

The establishment of the SCIC was aimed at improving the efficiency of state capital utilisation, by restructuring inefficient state firms and divesting state firms engaging in non-core business areas (Kim *et al.* 2010: 5). Since its operation in August 2006, it divested capital in nearly 520 state firms, including sales of the entire state stake in 466 local firms, for over VND 2.7 trillion (equivalent to USD 140 million) as of 2010. As of 2011, the size of state capital under the supervision of the SCIC was VND 15 trillion (equivalent to USD 750 million).

However, the SCIC has not yet acquired stakes in General Corporations and state economic groups. It has stakes in one-member limited liability companies, joint ventures and limited liability companies of two or more members and joint stock companies (Article 8, Decision No. 152/2005/QĐ-TTg). This suggests that, even though the Chairman of the SCIC is the Minister of Finance, the SCIS does not have enough power to acquire stakes in and exert an influence over General Corporations and state economic groups whose ultimate line manager is the Prime Minister, who the Minister of Finance reports to.

State big businesses as distributional coalitions

Although the number of state firms declined to 3,239 as of 2012 which accounts for less than one per cent in terms of the number of enterprises, their position in the economy has not shrunk but it is ever increasing through widespread diversification. Instead of using

⁹⁵ The Prime Minister Decision No. 152/2005/QĐ-TTg, promulgated on 20 June 2005 was titled “Approval of regulations on organising the State Capital Investment Corporation and its operation” (*Phê duyệt Điều lệ tổ chức và hoạt động của Tổng Công ty Đầu tư và kinh doanh vốn Nhà nước*).

resources in their core business areas to improve efficiency and technological progress in order to play the ‘leading’ role in nation’s economic growth, SOEs invest their resources into non-core business areas to make even more profits often at a cost to the national economy in terms of duplication and overcapacity in some areas. In other areas, like finance, investments and collusion between banks and holding companies have contributed to a growing problem of non-performing loans and financial vulnerability. To conclude with some caution, in the game of recentralisation and decentralisation played between the state and SOEs, the enterprises have been the victor in the first round in contemporary Vietnam.

The behaviour of SOEs, particularly of big state businesses, recalls the characteristics of distributional coalitions explored by Olson (1965, 1982). The distributional coalitions are defined as “organizations for collective action within societies that (are) overwhelmingly oriented to struggles over the distribution of income and wealth rather than to the production of additional output” (Olson 1982: 44) by using lobbying for legislation or cartelisation, which can lower the efficiency of the national economy. As a result, distributional coalitions reduce aggregate income in the societies in which they operate and make political life more divisive (Olson *ibid.*: 47).

We examined that SOEs before *doi moi* were quite dynamic given hard budget constraints and contributed to the state budgets. Why have these once dynamic business entities transformed into resource-wasting entities after market mechanisms were introduced? Why has this contrast happened? Fforde (2004, 2007) suggests a fancy idea that SOEs were in fact treated like as a private firm by their ‘virtual share owners’ who are not necessarily the state until the early 1990s. They were genuine business entities. However, in the 1990s and 2000s, the state tried to enhance the control over SOEs because of their significant role as a tax base. This recentralisation has made “the centre of gravity of virtual share ownership moved ‘upwards’ and away from interests close to

and within SOEs. This was experienced as a *reduction* in SOE autonomy.” (emphasis in original; Fforde 2007: 214). What the state wanted in exchange for this autonomy was the strengthening of state management over state firms, so as to retain over state control and to increase state revenues. This is in line with the argument of Painter (2003b) that state enterprise reform policies were intended to enhance and improve state governance. SOEs have lost their business mind while they have had better business environment.

Increasing influence over SOEs does not mean interrupting in daily operation. The analysis of the interview showed that there was no significant intervention by higher level governing organs in Hai Phong City. All firms answered that administrative intervention was not interruptive and governing organs do not interfere in daily business decision making, such as an annual production target and human resource management. In general, the directors and the representative of higher governing organs do not need to sit together regularly – quarterly meetings or submitting reports have become the normal form of contact between the two parties.

It is doubtful that whether the recentralisation has been successful. It gets more and more difficult and complicated for the state to exert influence over *far* diversified SOEs not only in terms of business areas but also and more critically in terms of blurred property rights represented by the mixture of the state and the private sector. Meanwhile, during this period of commercialisation, the power of SOEs has grown quickly together with their size while the power of the state over SOEs, in particular, over big businesses has become increasingly attenuated because General Corporations and SEGs, which were set up by the order of the Prime Minister and under his direct supervision, have equal status to line ministers. Moreover, their access to economic resources through retained profits and through investments in financial institutions has further increased their leverage in local governance, and in making links with local politicians and state officials. As a result, the party-state has in practice become even less centralised, with a marked development of

localised economic and political structures and a proliferation of interests that have direct or indirect inputs into policy formulation and implementation (Dixon 2004: 20).

Investment in non-core areas itself is not a problem. The problem is what these non-core areas are. For example, a petroleum company can establish a university which is specialised in inventing new techniques to search for oil and gas wells in deep water or it can construct a shipyard to construct oil tankers or drill ships. While establishing a university is not a core area of business of a petroleum company, investment in research and development is an essential part of operating businesses.

These two investments, of course, are unlikely to bring this company profits in the short run. Hence, this company is likely to hesitate to invest in long term projects and be tempted to favour the business plans which can create short run profits, such as real estate, hotel, banking, tourism and transportation services. However, without these research and development investments the survival of this company in the long run is highly questionable. Moreover, investments in these quick return sectors can divert attention and resources from the core activities of the firm. To the extent that the long-term economic viability of the country depends on investing in and developing the core manufacturing sectors, these short-term strategies can potentially have damaging long-term consequences.

Why do so many Vietnamese state firms opt for short-run profits instead of investing in long-run projects which are likely to bring healthier long-run profits? A director of a state company encounters several constraints: firstly, in Vietnam, if a state company records a loss for two consecutive years, the director of the company is dismissed; secondly, the director's interests may not coincide with the owner's – the state, as the director is not the residual claimant; and finally, the firm may have political constraints – sometimes the firm has to follow what is required by the state. For example, during our interviews, a

central state firm stated that it had to deliver food aid to Cuba from time to time upon the request of the state even if it did not create any profit for the company.

The first constraint is likely to make directors of state firms seek immediate profits as they are otherwise threatened by dismissal. If this factor is combined with a weak financial capacity – most state firms are largely dependent upon bank loans, then directors will rationally avoid long gestation investment plans. Their first priority would be to maintain the current business without making a loss rather than in investing for the long run profits. The fact that the main source of capital is bank loans means that the firms have to repay interest and the principal from net profits. All this induces a search for quick profits even if the consequences for the future of these companies are not promising.

The second constraint – conflicts of interests between directors and the state as an owner – also contributes to the short-termism. The interests of the state as an owner are not only to create profits (or not to lose state capital) but, more importantly, also to lead the national economy by developing critical fields that potentially have positive externalities for the whole economy. The state is both the residual claimant of individual state firms and also coordinator of activities across state firms to maximise the collective benefit.

In principle, the state can therefore play a critical developmental role, but the problem is that the state as principal cannot get its agents in charge of enterprises to behave accordingly. The agents have an interest in short-term profits and moreover in activities that are individually lucrative for enterprise employees but which can reduce profits and long-term viability of state firms.

The central state has adopted several steps to enhance its control over enterprises. The creation of big business groups can make sense in this perspective. A coordinated group

is in theory easier to manage from above, but in practice these steps resulted not in heightened control over agents, but even more autonomous behaviour by agents as discussed above. Unless the state provides a strong incentive system for directors, effectively making them joint residual claimants, they are not likely to engage in entrepreneurial long term investments. One of our interviewees explained that as a director of a state firm it was important for him not to “walk fast and get tired soon, but walk slowly and go longer” (a local SOE, Firm).

On the other hand, embezzlement can be an important problem because the director’s interests are to maximise his/her revenue not the firm’s revenue. To prevent the embezzlement resulting from the principal-agent problem, there must be a well working supervising mechanism to detect wrongdoings committed by directors but the state audit and inspection system in Vietnam has not yet reached that standard. To summarise, in the current Vietnamese context, it is difficult to expect that directors of state firms will choose long term strategic investment plans. Directors, firms and the national economy appear to be locked in a vicious circle of short-termism.

3. Government-linked companies in Singapore and Malaysia

This chapter examines the role of state-owned enterprises (SOEs) in late-industrialising countries or more commonly called government-linked companies (GLCs) in two Southeast Asian countries, Malaysia and Singapore. While privatisation was introduced to improve the efficiency of GLCs, it has not meant to weaken the state dominance. The market capitalisation of the twenty largest GLCs in Malaysia, G20, is RM425 billion as of May 2014 which accounts 35 per cent of total market capitalisation and GLCs in Singapore account for 35 per cent in terms of market capitalisation between 2008 and 2013 (Sim *et al.* 2014: 6). As mentioned briefly, both states keep the state share above fifty per cent in many of the privatised GLCs. Moreover, the private sector has been invited through privatisation but the invited private sector is not clearly distinguished from the public sector. The line between business and government has been *blurred* both in Singapore (Gainsborough 2009b, Hamilton-Hart 2000)⁹⁶ and Malaysia (Adam and Cavendish 1995a, Jomo and Gomez 2000, Salleh and Meyanathan 1993, Tan 2008).

The similarities have, however, not resulted in similar outcomes in industrialisation. Singaporean economy performance of Singaporean economy including that of GLCs has, however, outpaced that of Malaysian counterparts despite the similarities. It is interesting that the blurred private-public sector relationship has led to the efficient public sector in Singapore in spite of the potential for rent seeking and rent creation whereas a similar

⁹⁶ While there are plenty of studies explaining that the Singaporean government and the public sector operate efficiently, but few studies seek *why* by carefully examining the political economy of Singapore. Hamilton-Hart (2000) is one of available and nice studies and Gainsborough (2009b) conducted a comparative analysis with Vietnam in, another country showing a resemblance to the political economy of Singapore such as de facto a single ruling party, low level of freedom of criticism of the leaderships and a paternalist position against society and people.

political economic setting has largely resulted in rent-seeking and corruption and thus the inefficient public sector in Malaysia.⁹⁷

Albeit this chapter does not aim to explain the factors why the blurred business-government relationship has led to different outcomes it might be explained by the fact that the two countries have deployed its GLCs for different targets. Singapore aims at *efficiency* whereas Malaysia aims at *equality*. There has been trade-off between equity and efficiency in Malaysia but not in Singapore.

This chapter, at first, summarises Gerschenkron's argument regarding the role of the public investment in late-industrialising countries which he induced from the analysis of the European late-industrialising countries in the nineteenth century. Then this dissertation summarises the discourses on the rationale of state-owned enterprises (SOEs) which are actors of the public investment, followed by the study of Singaporean and Malaysian GLCs.

3.1. The rationale of state-owned enterprises

Gerschenkron's propositions on backward economies

The experience over the course of industrialisation in Japan and the first tier newly-industrialising economies (NIEs) in East Asia – South Korea (hereafter Korea), Taiwan, Singapore and Hong Kong – and the second tier NIEs in Southeast Asia – Malaysia, Indonesia, Thailand and Vietnam – evidences that the state can play a key role in

⁹⁷ Moreover it is said that the Singaporean government has not had any feature of so-called sound or good government such as democracy, the rule of law, the autonomy of government, transparency and the elite bureaucracy (Hamilton-Hart 2000: 202-3).

shortening industrialisation albeit the ways of playing the role are not identical (Jomo 2001, Shin 2002).⁹⁸

This does not mean that the state can replace the market but complements if there is insufficient or lack of private investment either because of low level of capital accumulation available to be allocated or the private sector does not have long-term commitment given the scarcity of capital because its return does not occur in the near term nor foreseeable. The scarce capital, therefore, is apt to seek profit-making opportunities in short-term investment at the cost of the long-term investments (Chang 2007: 6).

Public investment by the state is supposed to be an alternative to this failure. The role of the state in this discourse, contrary to the liberalist view point, is not limited to provide public goods and ensure the necessary rule of law for capitalist market transactions but also directly participate in capital mobilisation and risk-taking to catalyse investment in the areas which is essential for the long-term national economic growth but is likely to have very low level of or no investment at all if it left in the hands of the private sector such as transportation, postal and telecommunication services, health, education and scientific research capacity.

The idea that the state can play a certain role in the course of industrialisation goes back to Gerschenkron's analysis of the economic development in various advanced and 'backward' European countries in the nineteenth century. He summarised observed development patterns in six propositions. Although these findings were drawn from the

⁹⁸ See Shin (2002) for an in-depth analysis of the catch-up strategies taken by Japan and the first tier East Asian Newly Industrialised Economies (NIEs) – South Korea (hereafter Korea), Singapore and Taiwan – in which he juxtaposes Germany with Japan as moderately backward economies and Russia with the first tier East Asian NIEs as extremely backward economies.

experience of European economies two centuries before, many of these were found in Asian ‘backward’ economies such as Japan, Singapore, South Korea and Taiwan and other newly industrialising Southeast Asian economies including Thailand, Malaysia and Vietnam.

This dissertation focuses on institutional factors among Gerschenkron’s six propositions⁹⁹ which pointed out the role of the state such that

“the more backward a country’s economy, the greater was the part played by *special institutional factors* designed to increase supply of capital to the nascent industries and, in addition, to provide them with less decentralized and better informed entrepreneurial guidance, the more pronounced was the coerciveness and comprehensiveness of these factors” (emphasis added; Gerschenkron (1962: 354)).

He proposed that institutional factors in less industrialised economies which have little similarity to those in established industrial countries result in the “differences in the speed and character of industrial development” to a considerable extent (Gerschenkron *ibid.*, 7). One of the critical functions of those institutional factors is *channelling capital to*

⁹⁹ The rest five findings are the more backward a country’s economy,

- 1) “the more likely was its industrialization to start discontinuously as a sudden great spurt proceeding at a relatively high rate of growth of manufacturing output”;
- 2) “... the more pronounced was the stress in its industrialization on bigness of both plant and enterprise”;
- 3) “... the greater was the stress upon producers’ goods as against consumers’ goods”;
- 4) “... the heavier was the pressure upon the levels of consumption of the population”;
- 5) “... (and) the less likely was its agriculture to play any active role by offering to the growing industries the advantages of an expanding industrial market based in turn on the rising productivity of agricultural labor” (Gerschenkron 1962: 353-4).

industrialisation (see also Patrick 1966). He concluded that mobilising scare capital required to implement industrialisation was carried out in different ways:

“it is mobilised by factories in advanced area such as England; by factories and banks in the area of moderate backwardness such as Germany; and by the state, banks and factories in the area of extreme backwardness such as Russia” (Gerschenkron *ibid.*, 355).

One of the main arguments of Gerschenkron is that ‘relative backwardness’ of individual economies and therefore the so-called prerequisites¹⁰⁰ for industrial development are not necessarily replicated in all less advanced economies exactly in the same pattern which advanced countries passed in order to achieve industrialisation (Gerschenkron *ibid.*, 356-7). Hence, we have to understand the actions by banks and governments in less advanced countries as “successful attempts to create *in the course* of industrialization conditions which had not been created in the “preindustrial” periods precisely because of the economic backwardness of the areas concerned” (emphasis in the original, Gerschenkron *ibid.*, 358). Institutional factors channelling capital towards industrialisation can be replaced by the activities of the state and SOEs are agents executing public investments.¹⁰¹

¹⁰⁰ The idea there will be no industrialisation without having prerequisites was widely shared during the time of Gerschenkron. Rostow (1960) is an example whose opinion was summarised as the “abolition of an archaic framework in agricultural organization or an increase in the productivity of agriculture; creation of an influential modern elite which is materially or ideally interested in economic change; provision of what is called social-overhead capital in physical form” (Gerschenkron *ibid.*, 356).

¹⁰¹ The key role of the state, according to Chang (2002), is not unique in the industrialisation of current less developed economies. He argued that the intervention of the state was an essential part of the industrialisation of now-developed countries and these now-developed countries have kicked away the ladder for less-developed countries to become developed countries by forcing them to follow their advanced market-based institutional arrangements.

As public investors, what functions are supposed to be performed by SOEs? We frequently use the term of ‘state-owned enterprises’ to refer an entity run in public ownership. It is worth considering what features an SOE is supposed to hold. Gillis (1980: 252-3) provides three conditions which an SOE must hold as follows:

(1) The government is the principal stockholder in the enterprise or otherwise has the ability or the potential to exercise control ... (2) The enterprise is engaged in the production of goods and services for sale to the public, or to other private or public enterprises. (3) ... profit maximization is *not* the prime state objective, but which rather are expected to pursue profitability subject to constraints implicit or explicit in “social” functions assigned the enterprise by the state (emphases in the original).

In brief, an SOE is a *government-controlled* business entity engaging in the production of goods and services which bring benefits to the public.

Why SOEs are required while some private businesses can provide the same goods and services if the government contracts with private firms? Gillis (1980: 258-66) groups the rationale of establishing and running SOEs under three headings while it is not always easy to consider one reason separately from the others because decision making regarding setting up, running and liquidating SOEs require highly complicated socio-politico-economic consideration.¹⁰²

- Primarily economic motives – savings mobilisation, employment, capital lumpiness, natural monopoly and risk bearing;

¹⁰² We can consider a case of savings mobilisation as an example. By establishing a state organisation in charge of managing national pension funds would initially be based on the ‘economic’ motive to mobilise savings. This, however, will ultimately be grounded in a political motive because it also reflects a desire to shift reliance for savings mobilisation from the private to the public sector.

- Primarily socio-political motives – commanding heights, nationalisation after independence from colonialism¹⁰³ and social goals such as income redistribution and correction of imbalances in regional growth; and
- Mixed motives – anti-concentration of the private economy and aid donors’ preference to channel funds through SOEs.

One motive drawing our attention is ‘aid donors’ preference’ to SOEs in channelling funds because it seems contradictory to *present* common knowledge of the disapproving position of international donors such as the World Bank and the Asian Development Bank on the state interventions and the presence of SOEs. According to Gillis (*ibid.*), however, there was a coincidence of interests between the World Bank and the national decision-makers, making the World Bank have used SOEs to channel the funds.

“The World Bank saw significant advantages in fostering decentralized decision-making in areas involving the production and distribution of basic industrial and agricultural goods. At the same time, both the Bank and many officials in countries seeking Bank loans viewed *existing governmental departments* as either too inefficient or too corrupt to execute large-scale projects. As a result, SOEs became the preferred channel and many SOEs were established and expanded” (emphasis added; Gillis *ibid.*, 265).

Shipping companies, investment banks, fertilizer plants and SOEs in plantation agriculture in Indonesia are the examples. Nonetheless, this situation has changed. There was continuous growth of the private sector in these countries and the private sector is able to undertake large projects. The World Bank does no more prefer the SOEs channel

¹⁰³ Despite its recent insignificance, de-colonialisation motive was a popular and highly demanded reason to validate the nationalisation of the assets of colonial era during 1950s and 1960s. This rationale accounted for three quarters of the nearly 200 central government-owned enterprises in Indonesia primarily expropriated from Dutch interests in 1957 and British interests in 1962 and other nations such as Egypt, Ghana, Algeria, Peru, Mexico and Chile (Gillis 1980: 263).

and has paid negative comments on SOEs. In the publication, *Bureaucrats in Business* in 1995, the World Bank evidently shows its stance on the matter of the public enterprises.

On the other hand, Chang (2007: 12-3) and Perrotti (2004), without grouping, enumerate ‘natural monopoly’, ‘capital market failure’, ‘positive externalities’ and ‘equity concerns’ as widely accepted reasons of the existence of SOEs. Firstly, the existence of a ‘natural monopoly’ is one of the most frequently cited reasons. This was explained by Gillis (*ibid.*) under the category of economic reasons together with capital lumpiness and risk sharing.

Natural monopoly

A natural monopoly refers to a situation in which the technical requirements, such as large capital cost and economies of scale, of an industry are such that only one supplier may exist. When a natural monopoly exists, the supplier is able to extract high monopoly profits by charging high prices because there is no competition from other firms which plays the role of forcing price down to the level where the company earns zero economic profit. Such positions result not only in unequal distribution of economic surpluses, but also in economic inefficiency, as the monopolistic firm produces less than the socially desirable amounts of output.

Typical microeconomics text books explain that the government can intervene to control the price at which the average total cost of a monopolist firm is covered and leave the firm with the break-even status. Alternatively, under such circumstances, the government can establish an SOE and regulate to prevent abuse of market power by a natural monopolist firm. Similarly, public ownership of some industries such as natural resources (iron, mineral and crude oil and natural gas), chemicals, heavy engineering and postal services is justified because they are strategically important to provide essential input materials to the emerging manufacturing sector (Adhikari and Kirkpatrick 1990) whereas

Gillis (*ibid.*) explains this in terms of the ‘commanding heights’ under the category of socio-political reasons.

Capital market failure

Second justification for SOEs is capital market failure, where private sector investors refuse to finance projects that have high returns in the long run but carry high risks in the short term. For example, the Korean government set up the steel-maker Pohang Iron and Steel Company (POSCO) as an SOE, as the risk was considered too high by the private sector.¹⁰⁴ If the venture subsequently proved so successful, why did the private sector fail to finance it? This is because capital markets have an inherent bias towards short-term gains and do not like risky, large-scale projects with long gestation periods.

One of obvious solutions to capital market failure is to set up firms based on public ownership to undertake productive activities which were critical to the economy’s industrialisation process. Alternatively, the government can establish a development bank that finances risky, long-term ventures, rather than to set up and run productive SOEs itself. In most developing countries, however, it is likely that there is a shortage of

¹⁰⁴ Chang (2007: 10-11) introduces a brief history of POSCO as follows: “In 1967, the Korean government applied for a loan to build the country’s first modern steel mill to an international consortium that included the World Bank. The application was rejected on the grounds that the project was not viable. This was not an unreasonable decision. The country’s biggest export items at the time were fish, cheap apparels, wigs, and plywood. The Republic of Korea didn’t possess deposits of either key raw material – iron ore and coking coal. Furthermore, the Cold War meant it could not even import them from nearby China. They had to be brought all the way from Australia. To cap it all, the Korean government proposed to run this as an SOE. There could not be a more perfect recipe for disaster, so it was thought. The Korean government borrowed from some Japanese banks and set up the steel mill as an SOE, called Pohang Steel Company (POSCO), in 1968. POSCO started production in 1973. The company remained an SOE until 2000”.

entrepreneurial talent in the private sector and the necessary venture may not be set up even with the assistance of the development banks. In this case, setting up SOEs may be a more effective way to address capital market failure than setting up a development bank (Chang *ibid.*, 12).

Gillis explains this in terms of ‘savings mobilisation’. Given that many under-developed countries on the one hand have low level of domestic savings and lack accumulated capital accessible and on the other hand these countries are unable to secure tax revenue sources, it would be an optimal choice for them to engage in business directly by setting up and running SOEs to generate investment finance. If successful, the generated capital can be relocated to finance physical and human capital formation instead of letting it be dissipated through unproductive consumption because it belongs to the state (Gillis *ibid.*, 260). This contrasts to the case of privately general capital which is likely to be used for the short-term profit creation.

Externalities

Third rationale, externalities, is related the size of SOEs and the specific industries where SOEs dominates such as natural resources, textiles, steel and iron and ship building.

According to economic theory, the existence of externalities is likely to cause either over-production when there are negative externalities or under-production when there are positive externalities because private firms do not take into account social costs or benefit when they decide their profit maximising output. Neoclassical theory suggests that this market failure can be solved if the government levies taxes or provides subsidies to producers and consumers.

Nonetheless, if levying taxes and providing subsidies are costly, and the industries concerned have a high degree of spill-over effects on the economy via backward and

forward linkage, it would be a better option to set up SOEs to internalise externalities.¹⁰⁵

In particular, if the industries have positive spill-over effects, they are likely to have high employment inducement coefficients. Thus they can contribute to maintain employment.

The commanding heights argument is partly overlapped to the spill-over effects. In this discourse, it is argued that certain sectors of the economy are, due to their strategic position and the kind of linkages they generate, so significant to the development process that they should not be left in private hands but the state must control the industries via SOEs to guarantee socially responsible performance from these commanding heights of the economy (Gillis *ibid.*, 262).

Social goals

Fourth rationale is that SOEs may be set up to address equity concerns or social goals. In most cases, SOEs are assigned responsibilities intended to promote social or equity goals of society such as balancing the regional growth, preserving employment and delivering necessary services including postal, health care and publication services when they are set up. In such cases, an SOE is an easy way to ensure universal access to essential services for all citizens including socially vulnerable class (Adhikari and Kirkpatrick 1990, Chang 2007, Gillis 1980).¹⁰⁶ The Vietnamese government keeps claiming that SOEs such as Vietnam Electricity Group (EVN) and Vietnam National Petroleum Group (Petrolimex) fulfil their social goals. This is confirmed that EVN, Petrolimex and Vietnam Expressway

¹⁰⁵ Internalisation of externalities can be achieved without government intervention if property rights are defined clearly and negotiation costs are fairly small – the Coase Theorem.

¹⁰⁶ A similarity is found from a mixed reasons based on the ideology such that the governments of developing countries do not like the concentration of economic power in the hands of a small number of families which were significant in Pakistan, Chile and Peru. The government reacted to the concentration by nationalising the private domestic firms (Gillies *ibid.*, 264).

Corporation (VEC) have not earned a market return due to social mission by an IMF staff (Matheson 2013).

The rationale of SOEs we just examined raises a question: why private firms cannot provide the same goods and services if they operate under an appropriate regulatory regime? This question becomes more plausible if we consider criticism of public ownership and SOEs.

It is widely argued that public ownership is likely to hamper economic growth because of a 'tragedy of the commons'. There are several reasons why public ownership, compared to private ownership, tends to result in inefficiency. Researchers commonly rely on the principal-agent problem to explain the negative aspect of public ownership. Partly because of information asymmetry between managers and owners of state enterprises it is difficult to monitor managers of SOEs. Also partly because of lower level of incentive of owners to monitor the performance of SOEs which directly resulted from the fact that highly diffused ownership structure since all citizens are owners makes it unable for them to exclusively extract the benefit from monitoring the operation of SOEs (Alchian 1965).

On the other hand, SOEs are frequently requested to fulfil political objectives which are in many cases neither profitable nor clearly measurable such as maintaining and generating employment, investing in unprofitable but strategic areas and improving the inequality in income distribution (Adhikari and Kirkpatrick 1990, Gillis 1980, Shleifer 1998, Shleifer and Vishny 1994, World Bank 1995).

Given the inefficiency of SOEs, what if private firms provide the goods and services? If the government make contracts with private firms to provide goods and services, such as research and development investment, postal, railway and water services and if it is able to monitor the contracted private firms properly, it would overcome the problems from

public ownership. Will it be the case? It will be if we live in a world with zero ‘transaction’ costs which incur in almost every economic activity. It is impossible to it is impossible to specify all contingencies for which the contents of a contract – for example, the level of the regulated price ceiling or the amount of subsidy, may need to be revised. Such contractual revisions usually involve a lot of negotiation and even legal disputes, all of which can incur substantial transaction costs. It is particularly relevant for developing countries whose governments lack legal capabilities even more than they lack administrative capabilities (Change *ibid.*, 13-4).

3.2. Government-linked companies in Singapore

The public sector of Singapore is comprised of two main components – government-linked companies (GLCs) and statutory boards. GLCs are entities in which the government holds a controlling share through Temasek Holdings (Temasek hereafter) whose sole owner is the Ministry of Finance. Temasek directly owns majority shares of large GLCs such as Singapore Power (electricity and gas) and PSA International (ports), Neptune Orient Lines (shipping), Chartered Semiconductor Manufacturing (semiconductor), SingTel (telecommunications), SMRT (rail, bus, and taxi services), Singapore Technologies Engineering (engineering) and SemCorp Industries (engineering) and Singapore Airways Ltd. (Chang *ibid.*: 9).

On the other hand, statutory boards are part of the government’s civil services. The statutory boards are created by special acts and ordinances of the parliament and are solely owned by the state. They are empowered to perform specific functions and are funded by government budget allocation, government loans and government guarantees (Pillai 1983, Sim 2011). They include Public Utilities Board, Economic Development Board, Housing and Development Board and Public Utilities Board. These are managed

by boards of directors with representation from government ministries, the private sector, profession and other interest groups.

Temasek: overview

Temasek was one of holding companies wholly-owned by the Ministry of Finance (MOF). The Singaporean government set up the MOF for the control of properties that were previously held by the British Chief Secretary during the colonial rule of Singapore. The MOF was empowered to acquire, purchase, hold, transfer, dispose, or otherwise deal with real assets. It wholly owned several operational holding companies such as Temasek Holdings for commercial entities, including GLCs, Ministry of National Development (MND) Holdings for certain remnant, but mainly dormant, company shares, Ministry of Health (MOH) Holdings for hospitals and the Government of Singapore Investment Corporation (GIC), which invests Singapore's reserves (Ang and Ding 2006: 67).

When Temasek was formed, 36 companies were transferred to its control whose total amount of investment capital was SGD345 million. The government sends its representative to the Board of Directors (BOD) to monitor the performance of Temasek. The BOD of Temasek is composed of nine directors of which two seats are for official government representatives – Permanent Secretary of the Ministry of Trade and Industry (MTI) and Permanent Secretary of the Ministry of Finance (MOF).¹⁰⁷

A similar state organ – the State Capital Investment Corporation (SCIC) – exists in Vietnam as we examined in Section 2.2 (p. 76). Its significance in the economy, however, is far less than that of Temasek in terms of the size of portfolio it runs. The size of portfolio run by Temasek is SGD 215 billion (equivalent to USD 173 billion) as of 31

¹⁰⁷ Vietnam also sends its representative to equitised firms as a member of the Supervisory Board but the supervising function does not work well. Further discussion is followed in Section 3.4 of this chapter.

March 2013 (Temasek Holdings Ltd. 2013: 3) while that run by the SCIC is VND 14,423 billion (equivalent to USD 685 million as of 31 December 2013).¹⁰⁸

Temasek has GLCs and their subsidiaries as members. The way through which Temasek controls its member companies is to hold controlling share of GLCs which are called ‘first-tier’ companies,¹⁰⁹ and then these first-tier companies which have their own subsidiaries and affiliates hold controlling share of their own subsidiaries which are called ‘second-tier’ companies. Furthermore, there are cross-holdings among GLCs (Ang and Ding *ibid.*).¹¹⁰ Hence, Temasek can wield its strong influence over both first and second-tier companies without holding the shares of second-tier companies.

Due to its aggressive investment plans including acquisitions and mergers, many of the GLCs such as Singapore Airlines, Keppel Corporation, Sembawang Holdings and Singapore Technologies, became blue-chips stock on the Singapore Stock Exchange with extensive international interests since the 1990s. At the same time, the government used GLCs to advance the policy of regionalisation by investing in ventures in Southeast Asia including China (Sim 2011: 62).

¹⁰⁸ Information is from the SCIC website at http://www.scic.vn/english/index.php?option=com_content&view=category&layout=blog&id=16&Itemid=8 (accessed on 16 September 2014).

¹⁰⁹ As of 31 May 1999, the market capitalisation of first-tier public listed GLCs was SGD88 billion or 25 per cent of total market capitalisation of the Stock Exchange of Singapore. The share of Temasek in these GLCs amounted to SGD47 billion (Yeung 2002: 82).

¹¹⁰ This is how subsidiaries and affiliates of Korean *chaebols* are effectively controlled by a handful share portion of a single founder-owner family. For example, according to the information provided by Fair Trade Commission of Korea on 1 July 2012, the Chairman of Samsung group Kun-Hee Lee exerts his influence over 81 member companies by holding 0.52 per cent of total capitalisation only. Even if we add the shares held by his children and relatives, it is still below one per cent of total capitalisation as of April 2012 (<http://groupopni.ftc.go.kr/index.jsp>).

Temasek has consistently maintained its returns of nine per cent annually in total shareholder's return from its investment portfolio. This can be explained by the fact that Temasek remains the controlling shareholder of the strategic GLCs which are mostly national monopolies such as Singapore Telecom, Keppel Corporation in shipbuilding, DBS Bank (formerly known as Development Bank of Singapore), SMRT (in public transportation services including train, bus, taxi and underground) and Singapore Technologies (Sim 2011: 71). Another interesting research on why listed GLCs have shown a higher market value relative to book value than is the case with private companies is that investors assign a premium to GLCs over private firms because the very fact that a company is linked to the government and potential belief that that the Singapore government protects GLCs from failure (Ramirez and Tan 2004: 17).¹¹¹

Development plan and GLCs in Singapore

GLCs in Singapore have played an important role in industrial restructuring from factor-induced industrialisation relying on its initial comparative advantages in terms of location and labour in 1970s to high-tech based industrialisation in 1990s to regionalisation after 2000 with a relatively strong presence of MNCs (Ghestquiere 2007, Low 2001, Shin 2002).

The original purpose behind the government's involvement was to accelerate Singapore's economic development by initiating industrialisation in the early 1960s (Ang and Ding 2006). As part of the effort for the industrialisation drive, the government took an active entrepreneurial role by investing in a wide range of companies in the manufacturing,

¹¹¹ The rapid growth of GLCs and statutory boards has led, however, to a different concern, namely that they encroach upon too many non-strategic industries, crowding-out smaller private companies and hindering the development of a critical mass of thriving local companies Ghestquiere (2007: 97).

financial, banking, trading, transportation, shipbuilding and other service sectors.¹¹² GLCs and statutory boards are the agents of this entrepreneurial state.

While GLCs have played key roles in industrialisation in Singapore, the role of industrial policy is not clearly observed because there is an equally heavy reliance on FDI by MNCs for capital, expertise, technology and markets (Low *et al.* 1993). As Singapore neither has a large domestic market nor sufficient resources, it chose ‘complementing’ catch-up strategy instead of ‘substituting’ one which Japan and Korea pursued to industrialise (Shin 2002).¹¹³ The Singaporean government wisely utilises the dominating MNCs by creating the environment through incentives and market-supporting facilities, which has induced MNCs and FDI to invest in Singapore (Low 2001: 113). The GLCs in Singapore have filled the areas which the government regarded as strategic to the country’s development such as shipbuilding, steel-making and telecommunication.¹¹⁴

In the initial phases of Singapore industrialisation between 1960s and 1980s, the state and GLCs helped to restructure and diversify the entrepôt economy into labour-intensive, low-value added manufacturing mainly set up by FDI and MNCs. Since the late 1970s, a transition was to be made to higher-value added manufacturing, substituting capital, technology and skilled labour for low-valued added activities. At the same time,

¹¹² In addition, the government commands the use of large amounts of Central Provident Fund (CPF) savings which is an individual mandatory savings scheme originally meant as retirement income (Ghestquiere 2007: 3, 93).

¹¹³ The substituting catch-up refers to a strategy which a less-developed country in order to compete with developed countries chooses some alternatives to overcome the lack of the prerequisites of development such as capital, technologies or efficient financial intermediaries. On the other hand the complementing catch-up refers to a strategy that without competing with its forerunners providing MNCs with ‘complementary assets’ such as infrastructure, human capital and fiscal incentives in order to achieve industrialisation (Shin *ibid.*, p. 4 and p. 20).

¹¹⁴ Some of GLCs were set up with the withdrawal of the British army. Left with the naval base and its full complement of infrastructure, equipment and trained human resources, the state promoted thriving ship-repair and build GLCs which extended to oil rig construction later (Low 2001: 115)

horizontal industrial expansion shifted to greater vertical integration as MNCs began to weave webs of linkages involving transnational production. Since 1990s, Singapore has chosen a clustering-based regionalisation development strategy.¹¹⁵ Instead of relationship based on dependence or patronage, a more mutual beneficial basis, with Singapore as an effective partner to the MNCs, has been adopted. This became more obvious when the regionalisation policy was launched in 1993. As MNCs moved operations elsewhere in the region as Singapore developed a new strategy to build up complementary and supplementary linkages (Low 2001: 115-7).

The state-business relations in Singapore

It is well known that the Singaporean public sector has not suffered inefficiency. It is said that policy is rigorously enforced, the government is efficient and corruption is rare in Singapore. This assessment originates from early studies on the political economy of Singapore. For example, Chan (1975) argues that Singapore was an administrative state, one in which the bureaucracy had become the real locus of politics and popular politics began to disappear and lobbying decrease dramatically in 1960s (Chan 1987). Majority of studies on Singapore's political economy have emphasised the independence of government and the separate, subordinate standing of local business class (Deyo 1981, Rodan 1989).

Singapore, however, does not have attributes of Anglo-American good government such as democracy, the rule of law and transparency, government independency and isolated bureaucratic institutions (Evans 1995, Haggard et al. 1997, Johnson 1982). Its power structure is essentially monolithic and the private sector influence over the government is not large (Chalmers 1992, Rodan 1989). Legal institutions are not independent of the

¹¹⁵ In the 1980s especially after the 1985 recession, the government emphasised the importance of small and medium-sized enterprises (SMEs) as they began to feel alienated by the nature of the overall growth process in Singapore in which they mainly served as sub-contractors for MNCs and GLCs (Low *ibid.*, 116).

government while they work efficiently (Jayasuriya et al. 2000). Despite its transparency in business environment, Domestic and foreign news media are effectively prevented from investigative reporting on areas the government considers sensitive, which includes the government itself (Seow 1998). The government owns extensive commercial assets (Lim 1983, Rodan 1989). Furthermore, the governing elite is not free of ties with economic actors and does not contain within it an insulated, bureaucratic core with the independence to resist particularistic demands from member of this elite (Hamilton-Hart 2000: 203). The state in Singapore is less autonomous, in the sense of clear separation of business and government and less bureaucratic than is generally supposed. Non-state and government actors have become entwined in terms of their interests, roles and career paths. Individual bureaucrats occupy important roles but they are integrated into a wider system of government which does not support bureaucratic centres of power (Hamilton-Hart *ibid.*: 198).

Economic rents from lucrative monopolies and concessions, as were granted to relatives and associates elsewhere, are avoided and opportunities for rent-seeking minimised, but why? Hamilton-Hart summarises the discourses on this issue into two lines.

One line is that Singapore is simply an oddity: small, peculiarly depoliticized and governed by a dominant individual whose aspirations and talents explain the country's successes. ...Complementing this picture, studies of Singapore's political economy have emphasized the independence of government and the separate, subordinate standing of the local business class, particularly in the early years of independence (Hamilton-Hart 2000: 196)

Alternatively, it is explained that there has been a key awareness of the need to run public enterprises on commercial and market-based principles (Ghestquiere 2007: 64). GLCs in

Singapore are intended to be instruments by which the state justifies to its shareholders – citizens – the active role it is playing in the economy. This desire has affected the way GLCs are structured, their incorporation of strict corporate governance, their investment decisions and their transparency (Sim 2011). They are professionally managed by private executives and operate on a commercial basis with a focus on bottom-line performance (Ramirez and Tan 2004). Private investment in the GLCs also provides a concrete foundation for a direct stake in the state. By engaging a substantial portion of private sector equity, the risk borne by government is reduced, as is the incentive for the private sector to see the GLSc simply as piggy banks (Hamilton-Hart 2000: 207).

The Singaporean government and the public sector, in contrast to general perception, are not independent of and separated from businesses. The senior civil servants and politicians in Singapore are never completely isolated from business (Sim 2011:75). For example, the directors and top managers of GLCs were heavily drawn from retired politicians and civil servants including brigadier-generals from the defence ministry in Singapore which gave rise to complex interlocking directorships within the government itself. As a result, the line between business and government has been more systematically *blurred* as the government incorporated private sector individuals through directorships (emphasis added; Hamilton-Hart 2000: 199).

In Singapore, like in many other countries, public enterprises have been progressively privatised. The line between business and government has been more systemically blurred as private sector individuals moved into state bodies and public sector personnel have acquired private sector business interests and positions. The statutory boards and GLCs have been used for amalgamation between public and private spheres. The governing elite span both public and private spheres, with the two sectors linked by shared interests, personal ties and overlapping career paths (Hamilton-Hart *ibid.*: 199-201). Often, however, public enterprises elsewhere failed to display the profitability,

budgetary discipline and dynamism found in Singapore, where GLCs have not been used for social or employment generation purposes (Ghestquiere 2007: 93-4). Low (1998: 23) explained this that “self-interest is guided by the strong visible arm of the government through benevolent state involvement”. However, why has still not been answered.

Singapore’s strict corporate governance expectations compared to the case of Malaysia (Anwar and Sam 2006). Vietnam is not an exception of the poorly-governed public sector. The corruption of government officials including the police are widely acknowledged (World Bank 2013) and the trust of people on SOEs is undermined due to the lack of transparency and limited access to the information on SOEs (Tran Huu Huynh *et al.* 2012, World Bank 2012). People answer that the most effective solution for SOE reform is improving transparency and that the least effective solution for SOE reform is no government guarantees (Tran Huu Huynh *et al.* 2012: 43, Figure 25). Smith *et al.* (2014) argues that the performance and governance of Malaysian GLCs has improved when they release more information to the public but the Vietnamese General Corporations and State Economic Groups (SEGs) are far behind of Malaysia and Singapore.

3.3. Government-linked companies in Malaysia

The Malaysian economy has shown stable economic growth for the last fifty years since its independence from the British in 1957 (see Figure 2, p. 138). It is the twenty-eighth largest economy in the world and the third largest in Southeast Asia as of 2012 in terms of GDP measured by the World Bank and its average annual growth rate for the last fifty years is 6.5 per cent.¹¹⁶

While the Malaysian economy has perceived as largely a market-based economy, there was a period in which explosive growth of state enterprises was implemented in the

¹¹⁶ GDP converted to international dollars using purchasing power parity (PPP) rates. The World Bank data, were accessed on 11 August 2013 at data.worldbank.org.

1970s. Briefly speaking, there were three phases in the development of GLCs and the state intervention: a *laissez-faire* period from 1957 to 1967, followed by a *state intervention* period with massive growth of GLCs from 1967 to 1982 and then a *privatisation* period which began from 1983 and it has been under reform through the GLC Transformation Programme (GLCT) launched in 2004 and planned to finish in 2015. Amid of these three stages, the rapid expansion of the state sector in Malaysia was closely related to politics which try to reconcile the conflict between Bumiputras and non-Bumiputras. The New Economic Policy (NEP) is a critical factor we have to consider in the examination of the development of the Malaysian economy after liberation from British colonialism. There has been a consistent policy in Malaysia over the three phases – strengthening Bumiputras’ economic base, which has produced a skewed outcome and made the public sector inefficient.

Significance of GLCs in the economy: Overview

It is perceived as being a fundamentally market-oriented but it has relatively large number of state-owned enterprises or government-linked companies (GLCs). There, however, were over 1,100 SOEs which are not only engaged in core utilities such as transport, communications, water supply, energy and finance but also in non-traditional sectors such as services, construction and manufacturing by the mid-1980s through nationwide state intervention (Adam and Cavendish 1995a: 15). The number of GLCs has reduced through active privatisation move which began in 1983 and the following GLCs Transformation Programme launched in July 2005. The number of GLCs listed on the Kuala Lumpur Stock Exchange (Bursa Malaysia) is 57 as of July 2005 of which 15 largest GLCs called G-15 accounts for about 65 per cent of the market capitalisation of listed GLCs (Putrajaya Committee on GLC High Performance 2006: 38).

The Malaysian government defines the G-15 as “a selection of 15 GLCs held by the Government-linked Investment Company (GLIC) constituents of the Putrajaya

Committee on GLC High Performance (PCG) and includes Maybank, Telekom Malaysia Berhad, Tenaga Nasional Berhad, Bumiputra-Commerce Holdings Berhad, Golden Hope Plantations Berhad, Malaysian Airline System, Proton Holdings Berhad, Kumpulan Guthrie Berhad, Affin Holding Berhad, UEM World Berhad, Boustead Holding Berhad, BIMB Holdings Berhad, Malaysian Resources Corporation Berhad and Malaysia Building Society Berhad” (Putrajaya Committee on GLC High Performance 2006: 38).

According to the information provided by the PCG, this G-15 has been transformed to the G-17 as of February 2013 after merges, demerges and other corporate exercises. Many of G-15 companies still remain in the G-17 (see Table 6, p. 106).¹¹⁷ GLCs revenue as a percentage of GDP was 17.4 per cent as of 2010. This was much lower than what Singapore recorded, 48 per cent, but similar to that of China and Thailand (14.5 per cent) and much larger compared to India (6.5 per cent), the US (1.68 per cent) and Australia (3 per cent) (Chakravarty and Ghee 2012: 54-5).¹¹⁸

¹¹⁷ Two companies removed from the G-15 are Golden Hope Plantation Berhad and Proton Holdings Berhad while Kumpulan Guthrie Berhad was acquired by Sime Darby Berhad and Bumiputra-Commerce Holdings Berhad turns into CIMB Group Berhad which is newly added to the G-17. Three other companies newly added are Axiata Group Berhad, Malaysia Airports Holdings Berhad and TH Plantation Berhad. Information was collected from the PCG website at <http://www.pcg.gov.my> (accessed on 3rd July 2014)

¹¹⁸ Chakravarty and Ghee included GLCs in which the respective government had a stake of fifty per cent or more. Although those numbers cited do not precisely map out the exact contribution of GLCs, private players and multinational corporations in each country, as revenue of GLCs includes contribution from overseas, they can be proxies for how big the GLCs are relative to the size of domestic economies (*ibid.*)

Table 6: Large 17 GLCs in Malaysia as of 2010 (unit: RM million)

Name	Main business area	Market capitalisation
Sime Darby Bhd	Plantations	52,883
Axiata Group Berhad	Telecommunications	40,114
MISC Bhd	Shipyard/Shipping	38,701
Tenaga Nasional Bhd	Utilities	36,498
Petronas Gas Bhd	Utilities	21,449
Plus Expressways Bhd	Construction	21,000
Telekom Malaysia Bhd	Telecommunications	12,557
Petronas Dagangan Bhd	Utilities	10,908
UEM Land Holdings Bhd	Property	8,377
Malaysian Airline System Bhd	Transport	6,985
Malaysian Airports Holdings Bhd	Construction	6,908
KLCC Property Holdings Bhd	Property	3,082
Malaysian Resources Corporation Bhd	Property	2,750
Proton Holdings Bhd	Industry	2,471
POS Malaysia Bhd	Utilities	1,804
TH Plantations Bhd	Plantations	1,016
Chemical Company of Malaysia Bhd	Industry	733

Source: Putrajaya Committee on GLC High Performance (2011)

Laissez-faire Period (1957-1969)

The state sector was not large when Malaysia achieved independence from the British in 1957 and the minimal market intervention was continued until the outbreak of the May 1969 riots.¹¹⁹ The Malaysian leadership, at the early stage of independence, chose the

¹¹⁹ The 13th May 1969 incident refers to the Sino-Malay sectarian violence in Kuala Lumpur, Malaysia, in which many Malaysians died. Officially the number of deaths was

policy in which Malays retain political control while non-Malays, mainly Chinese and Indians, were allowed to pursue their commercial interests.¹²⁰ This was called as the “Bargain of 1957” which was acknowledged as *laissez-faire* policy (Adam and Cavendish 1995a: 14). The Bargain of 1957 led to the resentment of Malays towards the Chinese domination of the economy which ultimately caused the May 1969 riots.¹²¹

This *laissez-faire* policy was influenced by the British. Between 1957 and 1960, public expenditure was mainly on infrastructural development (50 per cent) and agricultural and rural development (23 per cent), with only 1.4 per cent allocated to commerce and industry development (Lim 1985: 41). The Merdeka (Independence) Constitution preserved the colonial legal and administrative framework, especially protection of the property rights of British business interests (Rasiah and Shari 2001). A business-friendly environment was assured. Thus, the post-colonial Malaysian government continued to promote private enterprise, while the economic interests of the ex-colonial power were protected and greater foreign investment inflows encouraged (Jomo and Gomez 2000: 284). As a result, the foreign sector, with 62 per cent of share of corporate assets, dominated the Malaysian economy when the NEP was launched in 1971.

played down, but Western diplomatic sources put the toll at close to 600, with most of the victims Chinese. The racial riots led to a declaration of a state of national emergency or Darurat by the Yang di-Pertuan Agong (the Head of state of Malaysia) resulting in the suspension of the Parliament by the Malaysian government, while the National Operation Council was established as a caretaker government to temporarily govern the country between 1969 and 1971 (http://en.wikipedia.org/wiki/13_May_incident_%28Malaysia%2, accessed on 16 September 2013).

¹²⁰ A political group which began the campaign of independence of Malaya was a coalition of the leading Malay (United Malay National Organisation – UMNO), Chinese (Malayan Chinese Association – MCA) and Indian (Malayan Indian Congress – MIC) political parties, and it has remained in government ever since. As a result, the equitable growth for all three groups is inevitable value in Malaysia’s political economy.

¹²¹ In fact, what dominated the Malaysian economy after independence was British capital but economic inequalities were wrongly perceived along ethnic lines partly because Chinese businesses were conspicuous in the countryside where they took over rural transportation and rice milling, and acted as intermediaries between British capital and the Malay peasantry (Bowie 1991, Lim 1985, Tan 2008: 42).

At the time of the outbreak of the May 1969 riots, the Bumiputras' share in total corporate wealth remained at 2.4 per cent (Jomo and Tan 2003: 5). Similarly, Adam and Cavendish (1995a) reported that foreigners owned 62 per cent, non-Bumiputra Malaysians 34 per cent and the Bumiputras four per cent out of all corporate assets in 1970. Also an analysis of poverty among ethnicities estimated that 56 per cent of Bumiputras households had a monthly income of less than RM120, compared with 13 per cent for the Chinese and 20 per cent for the Indians (Snodgrass 1980, recited in Salleh and Meyanathan 1993: 3).

The New Economic Policy and the State Intervention Period (1969-1983)

To respond to the May 1969 riots, the Malaysian government announced the New Economic Policy (NEP) whose main target was to strengthen the economic foundation of Bumiputras. One of its announced targets was to reach the Bumiputras share of corporate wealth up to 30 per cent by 1990s.¹²² We may interpret the setting up of the NEP as the Malaysian government accepted the failure of the *laissez-faire* economic policy implemented the first decade after independence to achieve a socially acceptable wealth and income distribution among ethnic groups, especially to disadvantaged Bumiputras.¹²³

¹²² One of the NEP objectives was the promotion of overall economic growth and the “economic objective of national unity may be expressed as the improvement of economic balances between the races or the reduction of racial economic disparities” (Adam and Cavendish 1995a: 14).

¹²³ But it is argued that Bumiputras actively requested their economic share through mass organisations. For example, the Bumiputra Economics Congress (BEC) was introduced in 1965 and delegates at the second BEC in 1968 threatened to cause political instability if Malays were not given their share of the economy. The demand made here was subsequently incorporated in the NEP (Lim 1985: 44-5).

Table 7: Ownership of share capital of limited companies, 1969-2008 (per cent)

Year	Bumiputras' share	Non-Bumiputras' share	Foreign share
1970	2.4	28.3	63.4
1975	9.2	n.a (34)*	53.3
1980	12.5	n.a. (45)*	42.9
1985	19.1	34.6 (57)*	26.0
1990	19.2	46.5	25.4
1995	20.6	42.4	27.7
1999	19.1	39.4	32.7
2004	18.9	40.2	32.5
2006	19.4	43.5	30.1
2008	21.9	36.5	37.9
NEP target by 1990	30	40	30

* The data for these three years are adopted from Adam and Cavendish (1995a)

Sources: Gomez (2013:89), Table 3.1 and Adam and Cavendish (1995a).

The NEP was implemented through Malaysian five-year plans and incorporated firstly into the Second Malaysian Plan which lasted from 1971 to 1975.¹²⁴ Active government intervention began to achieve the targets, including the compulsory transfer of shares to the Bumiputras and the creation of specialised financial institution who worked as holding companies for Bumiputras. As Table 7 shows, the share of Bumiputras steadily increased from four to eighteen per cent over fifteen years and during the same period non-Bumiputra Malaysian share rose from 34 to 45 and 57 per cent while foreign share decreased sharply from 62 to 25 per cent.

¹²⁴ The Second Malaysian Plan (1971-1975) is a part of New Economic Policy (NEP) announced in 1970 whose purpose was to create the conditions for national unity by reducing poverty and reducing inter-ethnic disparities, especially between the indigenous, mainly ethnic Malay Bumiputras and the mainly ethnic Chinese non-Bumiputras (Jomo and Tan 2003: 1)

Increasing the share of Bumiputras by 7.5 times in twenty years, however, was not an easy task at all. Even after thirty years of the commencement of the NEP, the share of Bumiputras was still below the target. A government report documents that the Bumiputras' equity share was 19 per cent by 2005 and it increased up to 21.9 per cent as of 2008 (Putrajaya Committee on GLC High Performance 2011: 20). While the growth of Bumiputras' share has stalled the foreigners' share has recovered over the period of privatisation during which the government intervention has weakened and various strategies have been implemented to attract foreign capital.

How did the Malaysian government increase the share of Bumiputras?

As we examined, the economic base of Bumiputras was significantly weak while foreigners and non-Bumiputras dominated the economy when the Malaysian government began the NEP in 1971. Under this situation, the Malaysian government had very few alternatives available for them to choose other than to use public investment to achieve the triumphant goal and this resulted in an explosive increase in the number of GLCs. Bumiputra participation in government-approved manufacturing projects began to grow rapidly between 1975 and 1985, with equity participation always above 40 per cent (Jomo and Gomez 2000: 290).

The growth of GLCs in Malaysia is described in Table 8 (p. 112). It demonstrates that there were 88 GLCs during the era of *laissez-faire* followed by rapid growth together with the launch of the NEP in the 1970s.¹²⁵ The number of GLCs soared up to 547 by the end of 1980. Establishment of GLCs occurred in almost every area with the highest growth in the manufacturing and the services sector from five to 314 and to 293

¹²⁵ Three types of enterprises were classified as public: i) Departmental enterprises that were required by law to maintain their financial accounts in accordance with commercial standards; ii) Public corporations and bodies established by state and federal statutes; and iii) State-owned companies established under the 1965 Companies Act. The difference between the second and third group was that the former were 100 per cent government-owned while the latter either wholly or partly owned by the government (Salleh and Meyanathan 1993: 15).

respectively which accounted for around 55 per cent of the newly created GLCs. The reasons of this sharp increase in these two sectors were because they were the sectors dominated by Bumiputras but also the government attempted to reduce regional income inequalities by focusing on these sectors. Unfortunately, however, they fared badly in terms of profitability (Salleh and Meyanathan 1993: 21). Among these newly established GLCs, 556 belonged to the Federal government and 553 to the State government (Adam and Cavendish 1995a: 21, TABLE 1.7).

The public investment became as an important tool to increase the share of Bumiputras. Public spending escalated sharply in the 1970s while the Malaysian government implemented the NEP and the growth of public enterprises was one aspect of a general widening scope of the public sector. One of the main roles of public enterprises was declared in the Second Malaysia Plan (1971-1975) as one of the instruments for redistributing wealth and creating a Bumiputra commercial and industrial community. This tendency of creating public enterprises started to be weakened when then Prime Minister Mahathir Mohamad declared the privatisation of public enterprises (Jomo and Tan 2003).

Table 8: Growth of GLCs in Malaysia as of 1990

Sector	Before 1960	1960-1970	1971-1980	1981 onwards	Total
Agriculture	4	6	73	59	142
Building & construction	2	7	56	65	130
Extraction industry	0	3	22	6	31
Finance	3	14	61	44	122
Manufacturing	5	35	172	102	314
Other industrial	0	0	0	10	10
Services	5	10	135	143	293
Transportation	5	13	28	23	69
Total	24	88	547	452	1111

Source: Central Information Collection Unit (CICU), Permodalan Nasional Berhad¹²⁶; (Adopted from Salleh and Meyanathan 1993: 20), Table 4.

Laws and regulations

Various laws and regulations were promulgated to increase Bumiputras' capital share.

One of examples is the 1975 Industrial Coordination Act. The Act mainly alarmed Chinese investors who perceived the Act as an attempt to advance Malay interests in the manufacturing sector at their expense. For example, the Act gave the government increased authority over the establishment and growth of manufacturing firms and most importantly manufacturing licences from the Ministry of Trade and Industry could be revoked if requirements for Bumiputra ownership and employment were not met. Also the Act had a mandatory clause that foreign and Chinese companies should ensure a

¹²⁶ The Central Information Collection Unit (CICU) was formed and jointly operated by the Treasury and the National Equity Corporation (Permodalan Nasional Berhad) of Malaysia to monitor and analyse public enterprises in which the government equity participated (Salleh and Meyanathan 1993: 20). Another reason why the Malaysian government contracted the CICU was there was lack of a comprehensive database on the performance of GLCs (Adam and Cavendish 1995a: 16).

minimum 30 per cent Bumiputra ownership in all firms beyond a certain size.¹²⁷ The bureaucracy developed the means to try to induce manufacturing companies to sell stock, usually at discounted prices, to Bumiputras to achieve the Bumiputra ownership requirements set by the Act (Jomo and Gomez 2000: 289-90).

Another example is the 1968 Investment Incentive Act which was used by the government to increase the equity participation and employment of Bumiputras in foreign companies. The Capital Issues Committee, set up to regulate the growth of the capital market in 1968, put much more pressure to advance Bumiputra ownership of corporate stock. In addition, the Foreign Investment Committee was established to oversee foreign investments particularly to ensure conformity with the NEP (Jomo and Gomez 2000: 290).¹²⁸

Public financial institutions

Like Temasek in Singapore, the Malaysian government set up public holding corporations to increase Bumiputras' share. One of the main tools the Malaysian government used to increase the share of Bumiputras was to use public financial institutions such as Permodalan Nasional Berhad (PNB; National Equity Corporation) and Perbadanan Nasional Berhad (PERNAS; National Corporation). Especially, the role of PNB which was set up to accumulate and manage capital on behalf of Bumiputras was very unique in redistributing wealth. In addition to these public holding corporations, low interest rates, easy credit and preferential lending aimed to assist Bumiputra businesses and the state made larger funds available despite the poor track record of Bumiputra businesses (Jesudason 1989, recited in Tan 2008).

¹²⁷ This thirty per cent Bumiputra share regulation was removed in April 2009 when Mr. Najib Tun Razak replaced Mr. Abadullah Ahmad Badawi as Prime Minister to attract foreign capital as Malaysia experienced steep decline in FDI since 2000 (Gomez 2012: 71).

¹²⁸ The reactions taken by Chinese and foreign businesses were, for example, to diversify investment into overseas (Gomez 1991) or sought tight ties with politically influential but cooperative Malays (Bowie 1991).

As we examined, early initiatives of the NEP in pursuit of increasing Bumiputras' share involved direct compulsory share transfers to Bumiputra individuals and companies and the Majlis Amanah Rakyat (MARA; the Council of Trust for the Bumiputra) and the Bumiputra Stock Exchange were created over the course. This method, however, did not work well because of the resale of Bumiputra equity to non-Bumiputras and the government invented the concept of "ownership-in-trust" by establishing an investment trust dedicated to Bumiputras. As a consequence, the Yayasan Pelaburan Bumiputra (YPB; Bumiputra Investment Trust) was established in January 1978 under a Board of Trustees chaired by the Prime Minister and the PNB was created as an executive institution in March 1978.

PNB was able to borrow interest-free and non-collateral loans from the Malaysian government and it was able to increase its stockholding rapidly. It used its borrowed government capital to make investments. The investment into plantations was aimed primarily at buying up British enterprises while most of that going into the financial sector was for buying up Chinese banks and enterprises (Salleh and Meyanathan 1993: 22, Saruwatari 1991).

PNB evaluates, selects and purchases shares in public and private-sector firms and distributes selected shares to Bumiputra individuals through the Amanah Saham Nasional (ASN; National Shares Trust) which was set up by PNB in May 1979 as a subsidiary company to administer and market a unit trust scheme directed towards equity participation of Bumiputras. Shares in profitable GLCs were transferred to the PNB at par value and then some of these shares were transferred to the ASN, which then issued par-value units against the ASN share portfolio as a whole (Adam and Cavendish 1995a: 28).

The NEP and the budget burden

The main source of the state budget revenue of Malaysia is crude oil. In the mid-1970s, petroleum production began in Malaysia and the federal government captured the lion's share of oil rents instead of the state governments. The oil rents sustained much of the public sector expansion from the mid-1970s until the early 1980s, they have also been used since the mid-1980s to GLCs and finance prestige projects. Such fiscal irresponsibility seemed to increase with greater state intervention and the availability of enhanced oil revenues from the mid-1970s, until the economic and political crises of the mid-1980s brought about greater fiscal discipline and harder budget constraints for public enterprises, besides providing a rationale for privatisation (Jomo and Gomez 2000: 282).

The rapid increase in the number of GLCs resulted in rapid increase in the development expenditure which led to a budget deficit in 1970s and 1980s (see Table 9, p. 116). Total expenditure increased from 29.2 per cent in 1970 to 39.2 per cent in 1979 and peaked at 58.4 per cent in 1981 with the highest budget deficit of 20.4 per cent in the same year.¹²⁹ The public spending started to decline since 1983 when the Malaysian government could not run the budget deficit any more.

Public sector expansion under the NEP, however, was accompanied by other interventions which had a cumulative crowding-out effect, reflected in significant capital flight and declining private investment from the mid-1970s, and especially in the early 1980s (Jomo and Gomez 2000: 286). The eagerness to promote redistribution created distortions for the efficient functioning of GLCs, subsequently adversely affecting both efficiency and distributive equity (Gouri *et al.* 1991).

¹²⁹ The expansion of public expenditure was not entirely due to the growth of GLCs but coincided with a severe world recession. The Malaysian government ran expansionary fiscal policy to weaken the recessionary business cycle.

As a result, the public sector's share of GNP rose from 29.2 per cent in 1970 to a peak of 58.4 per cent in 1981, before falling to 25.3 per cent in 1993. The growth of GLCs was accompanied by declining capital productivity in the economy. The average incremental capital-output ratio rose from 2-3 in the 1970s to 5-6 in the early 1980s, while the public sector incremental capital-output ratio rose from 6-7 to 15-16 over the same period, though part of this aggravation might be attributed to setting-up GLCs in the heavy industry in the early 1980s (Jomo and Gomez 2000: 289).

Table 9: Consolidated public sector finance (percentage of GNP)

Year	Revenue	Development expenditure	Total expenditure	Overall surplus
1970	24.6	8.3	29.2	-3.7
1979	30.7	13.1	39.2	-8.1
1981	32.9	27.3	58.4	-20.4
1983	33.2	26.2	56.8	-17
1985	36.5	18.3	52.4	-4.7
1987	32.6	11.3	42.4	-5.1
1989	31.5	13.4	41.4	-6
1990	30.4	14.8	42.6	-8.3

Source: Salleh and Meyanathan (1993: 17)

Privatisation Period (After 1983)

As we examined briefly, the massive creation of GLCs over the state intervention period (1971-1983), contributed to improve the matter of poverty and ethnic inequality in wealth distribution. Nevertheless, it entailed criticism of a budget deficit and inefficient running of GLCs. This ultimately led to the discourse on privatisation of GLCs from the early 1980s.

The privatisation began when then Prime Minister Mahathir Mohamad made an announcement that Malaysia would carry forward privatisation in 1983, which was a

dramatic reversal of preceding state-led economic policy. It is claimed that the privatisation wave was affected not only by internal factors such as inefficient running of GLCs and a budget deficit but also by external factors such as liberalist and conservative reforms in the U.K. and in the U.S. (Jomo and Tan 2003: 1).¹³⁰

The government announced five objectives which it would achieve through privatisation in sought through privatisation in the *1985 Guidelines on Privatization* issued by the Economic Planning Unit (EPU) under the Prime Minister. The five objectives were 1) to relieve the government's financial and administrative burden; 2) to improve efficiency and productivity through competition and employee incentives; 3) to facilitate economic growth by increasing the role of the private sector in development; 4) to reduce the size and presence of the public sector; and 5) to contribute to the NEP which sought the reduction of poverty and inter-ethnic disparity in wealth (Jomo and Tan 2003:12 and Tan 2008: 52-3).

The Guideline clearly stated that “privatization will be implemented within the context of the NEP, indeed, privatization is expected to open up new opportunities for furthering the progress of the NEP.” In addition, while *the Guideline* declared that privatisation aimed at increasing the role of the private sector, it did not mean that the government would let the economy operate by itself. There were regulations which enabled the government to wield its economic leverage. For example, the government used the “special rights” or “golden share” which allowed the holder powers of veto over fundamental decisions of company. This is likely to be effective when relevant firms are strategic or socially important. Also there was a restriction that no one shareholder can hold more than 10 per

¹³⁰ It is claimed that the privatisation wave was very much consistent with Mr. Mahathir's own persona ideological and political preferences (Gomez 2002a, Jomo and Tan 2003). Even it is argued that privatisation had benefitted then Finance Minister Daim Zainuddin while then Prime Minister Mahathir Mohamad and then Deputy Prime Minister Anwar Ibrahim were more likely to were politically motivated to secure political foundation by rewarding their supporters (Gomez 2002b, Tan 2008)

cent of the stock when state firms were privatised following the intention of the government (Adam and Cavendish 1995b: 128-9).

In Malaysia the term privatisation is often understood to include cases where less than half of the assets or shares of SOEs are sold to private shareholders and it also includes cases of “partial divestiture where less than half of the assets or shares of SOEs are sold to private shareholders, with the government retaining control through majority ownership” and if widely applied, it includes cases where “private enterprises are awarded licenses to participate in activities previously the exclusive preserve of the public sector, as in the case of television broadcasting from 1984” (Jomo and Tan 2003: 11). Thus, the forms which privatisation took were sales of assets, licensing and build-operate-transfer (BOT) contracting.

Let us recall that the share of Bumiputras were around 12.5 per cent when privatisation began (see Table 7, p. 109). There was 10 per cent point increase compared to the level in 1970 but Bumiputras’ share was still far below the target (30 per cent) of the NEP. It was not an available option to terminate the NEP for the government. The method of pursuing the NEP, however, must have changed not only because of the increasing government debt but more importantly because of a growing internal tension.

By the mid-1980s there was growing dissatisfaction with the government among some of the more capable Bumiputra, both in the public and private sectors. By this point, large Malay-controlled business groups had already emerged on the corporate scene, and some were calling for a less regulated economy. Most of them grew since the early 1970 through protection, assistance and acquisition. As a result, they were either created by the state or at the least with crucial state support (Jomo 1993, recited in Tan 2008) and were heavily dependent upon the state over the implementation of the NEP which aimed at

creating Malay capitalists. Some of them viewed excessive intervention as having slowed economic growth, and hence counter-productive to their interests (Khoo Khay Jin 1992).

Private sector inefficiency

So far we pointed out that the inefficient public sector which resulted from the overwhelmed state intervention to enhance Bumiputra economic power caused privatisation. There was, however, another important factor we have to consider as a cause of the privatisation in Malaya. That was the *inefficient private sector* caused by unregulated government support to Bumiputra private businesses.

One of the main methods the Malaysian government used to enhance Bumiputra economic base was to take over established firms and provide new owners with ready-made companies. This quick control of profitable firms by state agencies increased Bumiputra ownership. This insulation from market competition and easy access to finance, however, undermined the possible disciplining experience of business management. (Gomez and Jomo 1997, Jesudason 1989, Tan 2008).

This consequently made Bumiputra private businesses rely heavily on the state and created a subsidy mentality among businesses. By the end of 1970, many private businesses failed despite significant support and demands grew for more protection and assistance in the form of easier credit, lengthier grace periods for loan repayment, more training, better businesses premises (Bruton *et al.* 1992: 295). This group of businesses, so-called pro-‘distribution’ faction or ‘bureaucratic class’, was tended to oppose privatisation and they were in fact most affected when the government tightened credit and adopted austerity measures in the mid-1980s (Tan 2008: 51).

There was, however, a group of businesses so-called pro-‘growth’ faction which involved a coalition of political and business elites. This faction had grown independent of state

sponsorship and patronage and viewed the NEP and state intervention as causing market distortions and obstructions to growth and new business opportunities (Crouch 1992, Khoo Khay Jin 1992). This group, therefore, preferred less state intervention and demanded privatisation. Privatisation thus

“represented a change in the way of resources were controlled and allocated ... and supported by an emerging group of big businessmen which stood to benefit from the sale of state assets at the expense of those who continued to rely on NEP-style assistance and hand-outs” (Tan 2008: 45).

Early privatisation (1983 – 1990)

There were 24 major privatisation initiatives handled by the Economic Planning Unit (EPU) by the first half of 1990 and forty non-financial public enterprises were taken over by the private sector as of 1994 among which the Malaysian Airline System was the first one sold (Salleh and Meyanathan 1993: 23).

After eight years of privatisation, the number of GLCs was 1,158 of which 556 belonged to the federal government, 553 to the state government and 49 to regional government as of 1990. The number of GLCs in operation was 903 (78 per cent) and 255 firm were either in dormant, in liquidation or inactive. The government hold 100 per cent of shares in 396 firms and a majority of shares in 429 firms, which summed up around 71 per cent (see Table 10, p. 122).

Federal GLCs tend to be fairly larger than those held by state or regional agencies both in terms of debt and equity capital which were much less likely to raise capital from sources other than the government. Foreign loans and domestic loans of federal GLCs stood around 79 per cent of their total borrowing while the majority of debt for state and

regional GLCs was to the government. Especially the capacity of regional GLCs to attract foreign capital was limited – only 12 per cent was mobilised from oversea. Nevertheless, the overall debt-equity ratio of 180 per cent was significantly higher compared to the private sector which was estimated around 100 per cent (Adam and Cavendish 1995a: 22).

Another indicator commonly quoted in evaluating the performance of GLCs after privatisation is the share performance of privatised firms compared to the overall Kuala Lumpur Stock Exchange (KLSE) composite index. In general, privatised firms' share prices outperformed the market average between 1985 and 1989. For example, the share price of Malaysian Airline System outperformed the market index by 100 per cent over the same period since its listing (Adam and Cavendish 1995b: 126).

Notwithstanding that the early privatisation had positive impacts, there was evidence showing that the privatisation had not entirely growth enhancing as the government anticipated. The total debt of GLCs, if it compared before and after privatisation, did not change much but remained incessantly around 20 per cent of GDP over the period between 1980 and 1988 as Table 11 (p. 123) shows. While the turnover of GLCs increased continuously up to 56 per cent, after-tax profits did not move in the same direction.

Table 10: GLCs Distribution in Malaysia, 1990

Industry	Status of firms				Government ownership					Capital in RM mil.	Capital, % of Total
	Active ^a	Non-op ^b	Liq/Rec ^c	Shell ^d	Total	100%	Majority	Minority			
Agriculture	115	23	3	6	147 (12.7%)	63	46	38		4,102	17.14
Construction	103	14	6	9	132 (11.4%)	42	55	35		1,324	5.53
Extractive	22	9	3	0	34 (2.9%)	6	18	10		523	2.19
Finance	115	14	2	3	134 (11.6%)	37	57	40		8,614	36.0
Manufacturing	246	42	24	7	319 (27.5%)	92	93	134		5,507	23.02
Services	249	46	15	4	314 (27.1%)	132	119	63		2,640	11.03
Transport	53	4	2	9	68 (5.9%)	17	38	13		1,210	5.06
Other	0	4	0	6	10 (0.9%)	7	3	0		6	0.03
Totals	903	156	55	44	1,158	396	429	333		23,926	100

^a Trading;

^b Dormant or pre-operational;

^c In liquidation or receivership;

^d Shell companies – paid-up capital of RM2 million, but no activity.

Source: Adam and Cavendish (1995a: 18-9), TABLE 1.2.

Table 11: GLCs performance, 1980-88 (% of GDP)

	1980	1981	1982	1983	1984	1985	1986	1987	1988
Turnover	45.3	39.8	36.5	37.4	41.3	44.4	47.9	54.5	56.2
After-tax Profit	13.8	9.2	7.1	4.6	6.4	6.1	5.0	4.1	5.6
Capital expenditure	0	6.3	7.4	8.3	6.8	3.5	3.1	10.3	1.8
Overall balance	13.0	2.0	-3.6	-7.6	-3.5	-1.3	-2.5	-10.0	-0.1
Total debt	19.2	23.9	25.8	24.8	22.0	24.1	26.6	29.9	24.8

Source: Adam and Cavendish (1995a: 24), TABLE 1.9.

Table 12: Pre and Post-privatisation share distribution for three GLCs (per cent)

Pre-sale	Federal government	State government	Bumiputra Interests	Other Interests	Employees	Other private
MAS ^a	90.0	10.0	0	0	0	0
MISC ^b	36.8	20.0	8.0	5.2	0	30.0
Sports Toto	30.0	0	0	0	0	70.0
Post-sale	Federal government	State government	Bumiputra Interests	Other Interests	Employees	Other private
MAS	60.0	10.0	11.0	0	5.0	14.0
MISC	29.4	16.0	14.8	4.2	0.6	35.0
Sports Toto	30.0	0	3.8	0	5.0	61.3

a MAS: Malaysian Airlines System

b MISC: Malaysian International Shipping Corporation

Source: Adam and Cavendish (1995b: 134)

The Malaysian economy coincidentally experienced economic recession from 1985 after privatisation implemented actively. It is hard to say this recession was caused by privatisation because there was a worldwide recession resulted from the oil shock which had a negative impact upon the Malaysian economy which largely depended upon exports (Jomo and Tan 2003, Salleh and Meyanathan 1993). External factors can explain better why the Malaysian economy experienced recession.

Assessing privatisation

One of striking features of the early privatisation in Malaysia is that the proceeds from privatisation were surprisingly small. Total proceeds from asset sales amounted to only 0.2 per cent of GDP, while the cumulative proceeds from all asset sales from 1984 to 1989 were equivalent to less than 0.1 per cent of GDP (Adam and Cavendish 1995b: 121).¹³¹ The under-valuation probably had a positive role to attracted investors. Nonetheless, it is argued that argued that this deliberate under-valuation which reduced the one-off revenues accruing from the sale of government assets as well as lease payments was made to “sell or lease to the politically influential and to secure public support for the program.” (Jomo and Tan 2003: 14).

This might be a reason why only a relatively modest transfer of equity ownership to the private sector. The Malaysian government disposed only a small fraction of the public sector during the first ten years of privatisation with only a little proportion of shares went to private hands (Adam and Cavendish 1995b, Galal *et al.* 1994). Table 12 (p. 123) shows how the distribution of ownership changed before and after three major privatisation projects of Malaysian Airlines System, Malaysian International Shipping Corporation and Sports Toto. It shows that the federal government’s share decreased

¹³¹ In the early privatisation, there was lack of consistent legal system. For example, the lands had been granted to GLCs were not in fact owned by them. A constitutional amendment was required to make it possible to transfer the lands to private firms, which was done in 1989 (Adam and Cavendish 1995b: 123).

from 90 per cent to 60 per cent through privatisation of which 11 per cent moved to Bumiputra interests, five per cent to employees and the rest 14 per cent to other private. There was, however, an around 8 per cent decrease in the share of private after the privatisation of Sports Toto.

We can assess the Malaysian privatisation whether it has achieved what it aimed for. The five aims were i) relieving the government financial burden, ii) improving efficiency and productivity, iii) facilitating economic growth, iv) reduce the presence of the public sector and v) meeting NEP targets (see p. 116).

Firstly, relieving the government financial burden: The government estimated that privatisation saved the government RM122-132.2 billion in capital expenditure which stood around 25 per cent of total development expenditure between 1981 and 2000, and RM7 billion in operating expenditure which represented less than one per cent of total operating expenditure (Malaysia 1996b, 2001a).

The associated costs of privatisation were RM5.1 billion in soft loans for privatisation projects and RM4.8 billion for projects with a high social component (Malaysia 1996b). On top of this there were around RM20-30 billion contingent liabilities. Furthermore, under-valued asset prices over the course of privatisation crowded out private investment (Jomo 2002: 14). The government earnings from the sale of equity and assets were RM12.7 billion and RM21.2-23.1 billion respectively (Malaysia 1996b, 2001a).

Nonetheless, the costs of government bail-outs, takeovers and renationalisation in assessing the performance of privatisation were not taken into account. If we consider the purchase of non-performing loans from privatised firms which amounts to RM47 billion by 2000 (Tan 2008: 60), it becomes unclear whether privatisation has relieved the government financial burden.

Secondly, improving efficiency and productivity: One of the features observed was that the majority were in sectors such as utilities, transportation, roads and telecommunications which are in general not the areas initiate privatisation in other countries (Adam and Cavendish 1995b: 99).¹³² For example, the establishment of TV3 introduced competition into the television broadcasting industry in which two government channels dominated. After the privatisation of the Kelang Container Terminal (KCT) in 1986, average turn-around time per vessel reduced from 11.7 to 8.9 hours. Telekom Malaysia introduced new services and improved existing services since its corporatisation in 1987 (Jomo and Tan 2003). It was reported that other two privatised ports – Penang Port and Johor Port – performed well with improved productivity and profits (Malaysia 1996b, Salleh and Lee 1990).

It also was accepted that the efficiency of GLCs improved through the early privatisation by which the dependence of GLCs upon government funding reduced and this gave privatised firms greater financial flexibility. At the same time, the process of asset sales tended to impose an external discipline on the balance sheet which enabled the privatised firms to improve their debt-equity ratio. For example, Malaysian International Shipping Corporation reduced its debt-equity ratio from 22:1 in 1984 to 1.5:1 in 1989 (Adam and Cavendish 1995b: 125).

Nevertheless, it was argued that much of this improvement was due to output growth which resulted from exogenous demand shifts and additional services (Tan 2008). In addition, the corporatisation of Tenaga Nasional Berhad (TNB), the national power company, saw a reduction in system losses and improvements in average fuel conversion

¹³² An in-depth analysis of major privatisation projects such as Port Klang Container Terminal (1983-6), Sports Toto Malaysia (1985-7), Malaysian Airline System Berhad (1985) and Malaysian International Shipping Corporation (1987) was done by Adam and Cavendish (1995b).

efficiency, and significantly improved infrastructure and strategic investment which reduced power outages (Leary 1998, cited in Tan 2008).

Thirdly, facilitating economic growth: The Malaysian government anticipated that privatisation was likely to promote economic growth through encouraging private investment and allowing private entrepreneurship in sector previously monopolised (Malaysia 1991b). It is true that the level of private investment increased and the growth rate exceeded GDP growth rates after 1986. The proportion of private investment, however, was over 60 per cent out of total investment even before privatisation launched and instead maintained at around 50 per cent out of total investment during the 1980s (see Table 13, p. 128).

In regard to promotion of entrepreneurship, we need to take into account the fact that many privatised firms enjoyed benefits from their monopoly status. If they are privatised, this monopoly powers will be handed over to private interests who are likely to use them to maximise profits (Jomo and Tan 2003: 11). As a result, many of build-operate-transfer (BOT) projects and licensed activities merely involve the private sector 'substitution' for what the public sector would otherwise have undertaken at lower cost to users (Tan 2008: 62). It is uncertain whether privatisation in particular contributed to economic growth in Malaysia (recall that Malaysia experienced recession in 1985-6 after the launch of privatisation).

Table 13: Private investment in Malaysia (1970-2000)

Year	Private investment (RM billion)	Share of total investment (%)	Share of GNP (%)
1970	1.5	67.9	12.1
1975	2.5	62.3	14.1
1980	10.4	62.6	20.1
1981	11.5	55.2	20.5
1982	11.4	50.0	19.0
1983	12.0	49.0	18.3
1984	13.3	52.6	18.0
1985	12.3	53.0	17.1
1990	24.2	64.7	21.9
1995	57.7	71.6	28.5
1997	87.9	73.8	39.2
1998	n.a.	57.9	18.5
2000	42.9	49.2	13.8

Adapted from Tan (2008: 62).

Fourthly, reducing the presence of the public sector: The presence of the public sector is reflected in public sector development expenditure (Tan 2008: 63). Both the level and the proportion of public expenditure decreased during the period 1986-1990 to RM57.7 billion compared to the period 1981-1985. In the following period, however, the level of expenditure increased again while its share out of GDP remained without big change at 14.8 per cent. We have to note the bulk of privatisation took place between 1986 and 1995 and the presence of the public sector did not become weak over the same period. Rather the public development expenditure began to increase again from 1996 in terms of both the level and the proportion (see Table 9, p. 116 and Table 14, p. 129). It is worth mentioning that the number of public firms created from 1981 to 1990 was 452, which amounted to 1,111 in total (see Table 8, p. 112). The presence of the public sector was not weakened following privatisation.

Table 14: Public development expenditure (1981-2005)

	1981-1985	1986-1990	1991-1995	1996-2000	2001-2005
Total (RM billion)	80.3	57.7	117.7	222.9	339.8
Share of GDP (%)	24.1	14.2	14.8	16.3	16.2

Sources: Malaysia (1986, 1991a, 1996a, 2001b, 2006)

Fifthly, meeting NEP redistributive targets: As we examined, privatisation contributed to achieve this goal. Bumiputras' capital share increased from 2.4 per cent in 1970 to 20.6 per cent in 1995 and then slightly fell to 18.9 per cent in 2004 but recovered and reached the highest at 21.9 per cent in 2008. This continuous improvement of Bumiputras' share, however, still below the initial target of the NEP – 30 per cent by 1990. On the other hand, individual Bumiputra share of capital increased from 5.8 per cent in 1975 to 18.6 per cent in 1995 (Tan 2008: 64). The concentration of individual Bumiputra share also increased from 39 per cent in 1975 to 41 per cent in 1983 to 67 per cent in 1988 (Jomo 1990: 476).

Government-business ties over the privatisation

In fact, in all the public share issues over the early privatisation projects, a trench of the issue was reserved specifically for Bumiputra institutions, while the open sale was subject to the requirement that a further one-third of shares are taken up by Bumiputra individuals and institutions. Therefore, the privatisation was in fact “a second phase in the NEP, through which the asset accumulation by the government on behalf of the Bumiputras is redistributed to individual Bumiputeras and Bumiputera institutions” (Adam and Cavendish 1995b: 129).

Whereas this goal was sought through state intervention in the 1970s, the same goal has been sought during the era of privatisation based on the accusation that GLCs accumulated losses which wasted investment resources, increased the government's financial burden and slowed down economic growth (Jomo and Gomez 2000).

Privatisation was not been accompanied by a strong commitment to promoting competition, allowing once-public monopolies to be taken over by private interests, thus essentially becoming private monopolies. Instead, privatisation was implemented through non-transparent procedures to a relatively small group of capitalist¹³³, both Bumiputra and non-Bumiputra, and to politically favoured state institutional investors and nominee companies (Barraclough 2000, Goh and Jomo 1995, Gomez 2002b, Jomo 1990). Hence, market processes and mechanism to reduce and eliminate rents hardly exist, while there is greater control over resources in the hands of a United Malays Nasional Organisation (UMNO)-dominated executive and a corporate sector dominated by politically linked companies and businesses.

Consultation between state and business was neglected in favour of inter-ethnic political bargains that benefited an unproductive rentier bourgeoisie beholden to a political patronage system legitimated by ethnic chauvinism and thus hostile to the discipline of market competition (Lubeck 1992).

Much of the rent obtained by this selected group has been secured by non-transparent means, sometimes even avoiding the semblance of market competition. These include the award of government contracts, the privatisation of state enterprises, subsidies from the state in the form of discounted loans and other privileges, and the appropriation of other rents created by state intervention, for example through business concessions carried out with government-issued licences (Jomo and Gomez 2000: 294-5).

¹³³ It is claimed that the bulk of major privatisation projects were awarded to close associates and even to family members of Mr. Mahathir and Mr. Daim. Mr. Daim also allegedly profited personally from some of the biggest privatisation projects such as the Malaysian Airline System and North-South Highway (Tan 2008: 72).

It is argued that privatisation was not successful because the government failed to address inherited inefficiencies and promote learning and commercial viability due to constraints posed by patron-client networks. As a result, by 2001, the government began scaling back privatisation programmes which gave a signal that its 'owner-manager' model was going to be replaced by the private owners with professional state managers (Tan 2008: 53). A new ten-year reform policy, GLC Transformation Programme, was launched in 2004.

Whereas the NEP aimed to increase Bumiputras' economic share, a group of non-Bumiputra businesses became beneficiary over privatisation. Following a severe recession in the mid-1980s, Mr. Mahathir had come to realise the importance of Chinese capital to sustain growth and promote industrialisation. In the early 1990s, he saw the opening up of China's economy as potentially lucrative for Bumiputra capital (Gomez 2012: 66). Furthermore, Tan (2008: 57), through an example that some private owners reported directly to then Prime Minister Mahathir, argued that privatisation regulation was personalised rather than formalised and the government intervened on *ad hoc* basis.

The Malaysian government has historically lacked disciplinary capacity, failing to withdraw subsidies or protection, which is contrasting to the case of South Korean government which delicately used the carrot-and-stick approach in enforcing its industrial and trade policy. Failure in the end was due to the state's inability to correct mistakes that were made based on ethnically or politically motivated decisions.

State's *credible* threat that there will be no bail-outs is essential for privatisation to be successful. This credible threat, however, may be compromised if privatisation projects involve public services because this public nature is likely to make the government unable and unwilling to allow such privatised enterprises to fail. Therefore, improving efficiency through privatisation depends not only on the quality of regulation but also on its effectiveness in delivering credible threats (Jomo and Tan 2003: 38).

The four cases of the renationalisation in Malaysia are good examples. Indah Water Konsortium (IWK, the national sewerage company), the light rail transit (LRT) system, Malaysian Airlines System (MAS) and Proton (the national car project)¹³⁴ evidenced that the government's credible threats can be influenced by the nature of privatisation projects.

While these projects suffered due to high capital costs necessitated some form of state subsidy, which in turn required an effective regulatory framework to ensure that the state did not subsidise inefficiency. The government neither offered a credible promise not to intervene nor increase the threat of state sanctions where performance targets were not met because of both ex ante and ex post reasons.

At the beginning of privatisation projects, the government had to choose candidates who would be in charge of doing project. Selected candidates in all four cases, however, were closely connected to sections of the ruling party, United Malays National Organisation (UMNO). Furthermore, the selection criteria could not but be biased because of the political objective which to create a group of Bumiputra industrialist.

Over the course of privatisation, required monitoring was not implemented properly due to weak government capacity. More importantly, however, there were political reasons. Electoral support required affordable sewerage charges and low LRT and domestic airfares, while Proton was central in the government's plans to promote Malay SMEs and employment opportunities. This meant that privatisation did not bring about a credible threat of bankruptcy (Jomo and Tan 2003: 38-42).

As a result, the process of capital accumulation was channelled to serve political and ethnic imperatives. Increasing intra-ethnic, rather than inter-ethnic, conflict has been the

¹³⁴ Proton is a subsidiary of the Heavy Industries Corporation (HICOM).

main cause of political instability since the May 1969 riots, and central to how resources have been allocated (Tan 2008: 65-6). Privatisation was a response to changes in social relations within the Malay community, specifically the emergence of the new Malay middle and business class pushing for a shift in resource allocation in its favour (Tan 2008: 66).

Privatisation beneficiaries were not competent enough because their selections were not based on strict economic criteria as political consideration outweighed economic optimality (Wedeman 2002). Furthermore, the Malaysian government's disciplinary capacity has been constrained since the 1970s and the state's failure to direct domestic capital into strategic manufacturing industries adversely affected industrialisation (Bruton *et al.* 1992, Jesudason 1989, Tan 2008).

3.4. Concluding remarks

This chapter reviews how GLCs have developed and what role they have played over the economic growth in Singapore and Malaysia to answer the question how the observed similarity such as that the public sector is dominant and the state is a controlling shareholder and the border between the public and the private sector is obscure has resulted in a different outcome in terms of efficiency of SOEs or GLCs (SOEs hereafter) in Singapore, Malaysia and Vietnam.

In Chapter 1, this dissertation argues that if the state seeks a political goal other than business profits by using SOEs, it is likely that those SOEs involved face *soft* budget constraints because the state is bound to help to achieve the political goal. From this viewpoint, Singapore in which not an explicit political goal has been pursued is different from Malaysia and Vietnam. Strengthening Bumiputras' economic foundation has been pushed ahead with in Malaysia and keeping the dominant state sector has been sought in

Vietnam. Consequently, the state-business relations have developed in a different way, which in turn makes the budget constraints which SOEs face either harder or softer.

For example, privatisation in Malaysia was not so successful because the political goal deterred rational selection of beneficiary private companies which were not competent but had close connections with politicians. Poor management of GLCs made the Malaysian government provide financial support or renationalise some of them. Similarly, the Vietnamese state supports big SOEs either explicitly and implicitly to keep the goal that the state sector plays the leading role, which has made budget constraints on them softer.

Another example is found in running public holding corporations. All the three countries set up a state-owned holding corporation – Temasek in Singapore, PNB and PERNAS in Malaysia and the SCIC in Vietnam – but supervising the running of state capital is not tight both in Malaysia and Vietnam. We examine that the government sends two ministers as representatives of the state to Temasek to monitor the running of state capital, which contributes to improve the portfolio performance of Temasek. Similarly, the Vietnamese state sends its representatives to equitised SOEs and they sit in the Supervisory Board which has the task of ensuring that the state's assets are being used in a proper way and according to the charter of the firm.¹³⁵

Nonetheless, the analysis of the interview suggests that the actual operation of the Supervisory Board suggests that it is relatively powerless and plays a passive role in monitoring the enterprise. If we look at how outside members become members of the Supervisory Board, this increases the doubt that the Board can be an effective monitoring

¹³⁵ The Supervisory Board operates independently of the Board of Management and the Board of Directors. Generally, the Supervisory Board is composed of three members including members from outside the firm. In principle, a member from outside is sent by the governing organs of the firm such as local People's Committees or General Corporations.

body. The outside members are not appointed by the governing organ but are elected at a shareholders' meeting after being nominated by the governing organ. As an official from the Department of Finance of Hai Phong told, "the nominated person must be qualified. Otherwise, the nominee cannot be elected. If the company does not accept a nominated person then there will be further negotiation with the firm to get the vote for a new nominee". Thus, the outside nominees generally have to be acceptable to the directors and senior executives of the enterprise, and this close relationship is unlikely to lead to strict monitoring that can embarrass the enterprise.

While a close relationship between the state and businesses deterred monitoring function in Vietnam and Malaysia, close connections between the state and the private sector have not resulted in a similarly outcome in Singapore. Frequent movements of personnel from the government to private businesses and GLCs and vice versa have resulted in holding multiple positions, which in turn has created an unclear border between the two sectors. It is assumed to have a non-positive effect on the monitoring problem and make vulnerable to corruption but it has not in Singapore, but why? Explanations mentioned in this dissertation are 'Singapore is simply an oddity', 'the independence of government and the business class', or 'people aware the need of running public enterprises on commercial and market-based principles'. The second argument is criticised by Hamilton-Hart (2000) that actually the distinction between the two sectors are systemically blurred and the third argument is not unique to Singapore. People know what is good, but knowing is different from doing. One hint suggested by Ghestquiere (2007) is that GLCs have not been used for social or employment generation purposes in Singapore. This is still an unanswered question.

4. State-owned enterprises in Vietnam

Vietnam has been one of the most dynamic economies in the world for the last two decades. It has recorded around seven per cent average annual growth rate in real GDP since the economic reform campaign, known as *doi moi*, was launched in 1986. This is a very impressive economic performance given that Vietnam was one of the poorest countries in the world in 1990 with 98 US dollars per capita GDP (World Bank 2012: 10). Twenty years later, Vietnam became a low-middle-income country in 2009 when it earned 1,020 US dollars (USD) per capita income and recorded USD 1,550 Gross National Income (GNI) per capita in 2012 according to the *World Development Indicators 2013* (viewed at <http://wdi.worldbank.org/table/1.1>).¹³⁶

The economic growth has led to a significant improvement in poverty reduction. According to the World Bank and the *Human Development Report* of the United Nations Development Programme (UNDP), the number of population living on less than one US dollar per day decreased from 63 to 13.1 per cent during the period of 1993 and 2008 (UNDP 2011: 144).¹³⁷

Vietnam has recorded around 7.8 per cent annual average growth rate over the last twenty years (see Figure 1 on p. 138). Only China has shown better performance than Vietnam with stability. Some countries such as Cambodia, Lao PDR and Malaysia recorded higher economic growth rate than Vietnam but they are volatile (see Figure 2 on p. 138).

¹³⁶ The World Bank uses gross national income (GNI) which was formerly known as gross national product (GNP) to calculate GNI per capita and to group countries based on incomes of 2010 measured in US dollars (USD). The figure of a low income country is USD 1,005 or below, USD 1,006 to USD 3,975 for a lower middle income country, USD 3,976 to USD 12,275 for an upper middle income country and USD 12,276 or more for a high income country (<http://data.worldbank.org/about/country-classifications>).

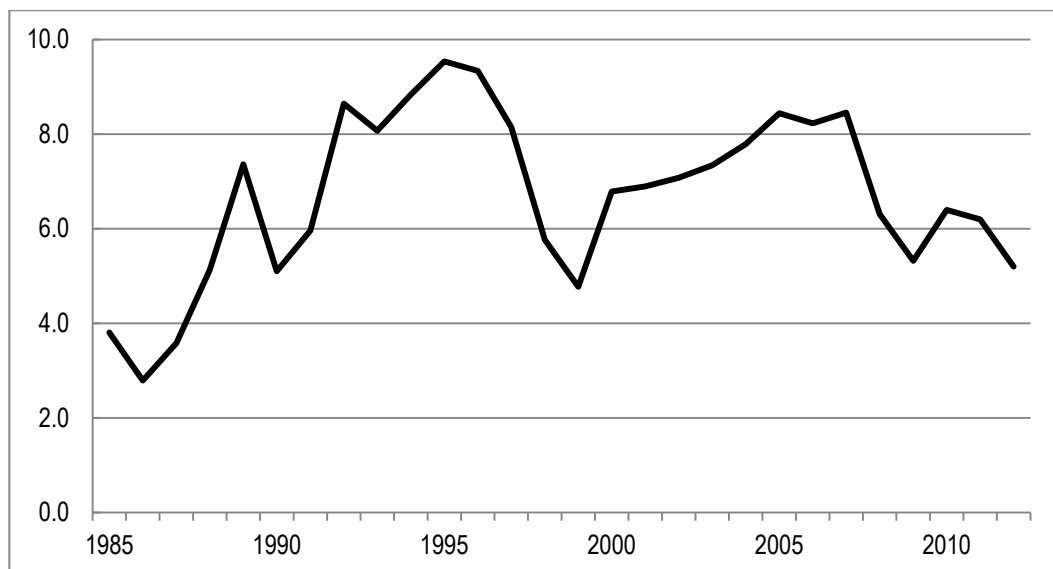
¹³⁷ In fact, the criterion the UNDP used is not one US dollar but 1.25 US dollars per day.

Vietnam's economic system changed from a planned to a market based type, and this change has apparently contributed substantially to its economic growth.¹³⁸ For mainstream neoclassical economists and international organisations following the so-called Washing Consensus, Vietnam is one of the greatest examples showing that the free market mechanism and economic liberalisation are the most critical conditions for economic growth.

It is not reasonable to reject the argument of the World Bank and mainstream neoclassical economists that the introduction of market mechanism and the economic liberalisation are the key factors of the economic growth. As can be seen from Figure 1 (p. 138), important economic events related to the economic liberalisation are positively related to the economic growth rates. *Doi moi* was launched in 1986; the price control was abolished in 1989; the USA lifted its embargo in 1994; and Vietnam became the 150th member country of the World Trade Organisation (WTO) in January 2007. Around these events the economic growth rate of Vietnam consistently showed upward movement except after accession to the WTO. This does not imply that joining the WTO has negatively affected Vietnam's economy because there were a series of global crises since 2007.

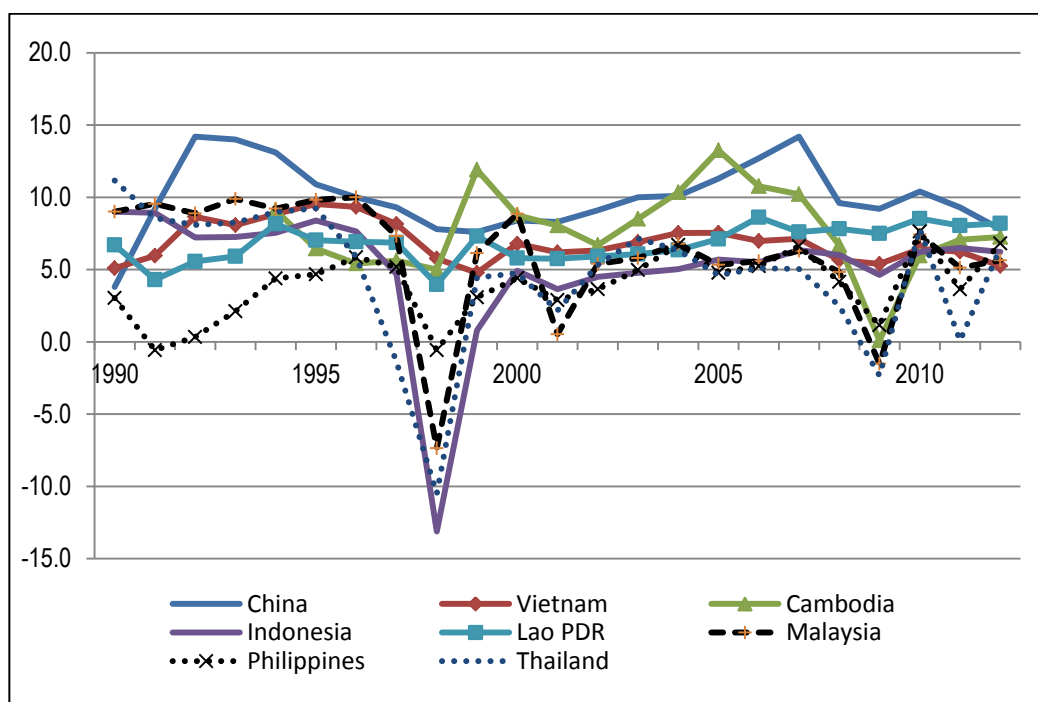
¹³⁸ According to the Constitution, Vietnam officially calls its economic system as a "socialist-oriented market economy" (Article 15, 1992 Constitution of the Socialist Republic of Vietnam).

Figure 1: Annual growth rate of Gross Domestic Product of Vietnam (1985-2012)



Source: *World Development Index 2013*, accessed at <http://data.worldbank.org>.

Figure 2: Growth rate of selected Southeast Asian economies, 1990-2012 (% per annum)



Source: *World Development Indicators 2013*, accessed at <http://data.worldbank.org>.¹³⁹

¹³⁹ The economic growth rate is measured at market prices based on constant local currency (<http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>).

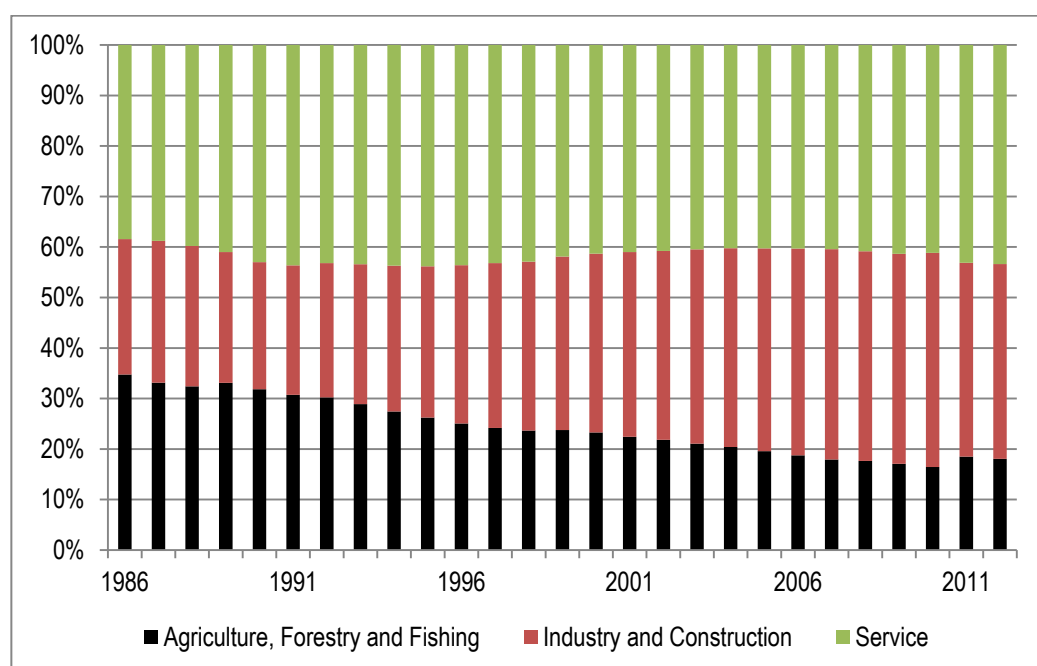
Over the economic growth, the GDP share of agriculture, forestry and fishery calculated based on the amount of value added decreased from 34.7 to 18.4 per cent, that of industry and construction increased from 26.8 to 38.3 per cent and that of services increased from 38.4 to 43.1 per cent between 1986 and 2011. While the industrial sector has grown, its GDP share is relatively small compared to that of the service sector. This implies that the firms operate in low value-added areas (see Figure 3 on p. 140). The value of exports increased annually by an average of twenty-one per cent. The main export items are natural resources including crude oil, agro-fishery products and low value-added labour intensive products such as shoes, clothes and furniture.

Furthermore, there is no robust evidence that Vietnam has run strategic industrial policy such as technology substitution or complementary strategy to catch up with advanced technologies and reduce the technology gap. There are many joint-venture companies in the automobile, motorbikes and electronics sectors and the Vietnamese parties, in most cases, provide land and labour, and deal with legal and administrative issues instead of utilising the foreign partners as a channel of technology learning and diffusion (Le Quoc Hoi and Pomfret 2011, Nguyen Phuong 2011).

The World Bank emphasises that the exemplary performance of Vietnam is largely attributable to the changes in incentives for people since the implementation of *doi moi*, growth of the private sector, devolution of the state and integration into the world economy (World Bank 2009: 132-6). Similarly, it is argued that the introduction of the market mechanism (Dollar 2002, Vu Quoc Ngu 2003), engagement in international trade (including foreign direct investment) (Auffret 2003, Gates 2000, Heo and Nguyen Khanh Doanh 2009, Nguyen Tien Dung and Ezaki 2005, Schmidt 2004) and public sector reforms (Leung 2010, Thoburn 2009, Tran Thi Bich *et al.* 2009) are the main sources of the success and further market oriented reforms should be followed to achieve sustainable economic growth. Vu Quoc Ngu (2002, 2003) argue that SOE reform which aimed at

liberalising SOEs and enhancing the incentive system had positive effects on enhancing SOEs' economic performance by estimating total factor productivity of SOEs which accounted for 40.9 per cent of the change in the industrial SOEs output between 1976 and 1998.

Figure 3: Share of GDP by economic sector in Vietnam, 1986-2012 (per cent share at 1994 constant price*)



* *Statistical Yearbook 2012* uses 2010 price as a base year for the calculation. For the consistency, the author converts the data for 2011 based on the 1994 constant price.

Sources:

1. General Statistics Office of Vietnam, *Statistical Yearbook* (2001, 2005-2013). Hanoi: Statistics Publishing House.
2. General Statistics Office of Vietnam (2001b). *Vietnam's Economy during the years of doi moi*. Hanoi: Statistics Publishing House.

Whereas the abovementioned studies accept that market mechanism is the most critical factor explaining the fast growth of Vietnam, they commonly suggest further reform is required to achieve sustainable growth. Their recommendations are to enhance the market mechanism further; to reduce the dominance of SOEs; to reform public administration

and improve state governance; to increase transparency in the budget system, policy decision making and property rights system.

The state sector in Vietnam: small or large?

Behind of this economic success which seemingly has resulted from economic liberalisation, we encounter a contradictory fact that *the state sector dominates Vietnam's economy*. Since the mid-1980s the share of the non-state sector increased and remained stable at around 50 per cent, of which the share of private sector has continuously increased up to 25 per cent (see Figure 4, p. 143).¹⁴⁰ Meanwhile, the share of the state sector has been lowered slightly from 40 to 37 per cent during the period of 1995 and 2010.¹⁴¹ The Vietnamese economy is still dominated by the state sector.

By the end of 1989, there were 12,297 state firms in operation in Vietnam. Thousands of loss making and inefficient SOEs were closed or merged reducing their numbers which dropped to 6,264 by the end of 1994. By 2000 this number was down to 5,759 state firms of which 3,692 were owned by the local governments and 2,067 were owned by the central government. The state restructured 3,183 state firms between 2001 and 2005. Among them 2,056 firms were equitised (as defined below); 252 were listed on the stock market; 416 were merged with other firms; 181 were dissolved or declared bankrupt. These figures account for 82.6 per cent of the total number of state firms targeted by the government for restructuring and 74.5 per cent of total state firms planned for equitisation. However, the trend towards rationalisation was partially reversed and 175 new SOEs

¹⁴⁰ The proportion of the private businesses within the non-state sector increased from 18 per cent to 25 per cent during the period of 2002 and 2010. During the same period, the share of the household businesses slightly declined from 66 per cent to 63 per cent.

¹⁴¹ The slight decline of the state sector's share in the national economy will be questionable if we take into account the fact that the foreign invested sector. Because foreign invested sector is composed of 100 per cent foreign invested firms and joint ventures of which the domestic partners are mostly SOEs. It implies that the state sector roughly has maintained its proportion in the economy despite various economic reform policies.

were added at the central level between 2010 and 2011 (VietNamNet news on 14 November 2005, Dixon 2003, World Bank 2012).

To understand better what the state and the non-state sector refer, it may be worth explaining terms used in the official statistics data of Vietnam. The official data published by the General Statistics Office (GSO) of Vietnam distinguish three types of ownership: state, non-state and foreign invested area.

Firms belong to the state sector (*Doanh nghiệp Nhà nước*) are 1) enterprises with 100 per cent of state capital operating according the Enterprise Law and under the control of central and local governments; 2) limited companies (*công ty trách nhiệm hữu hạn Nhà nước*) under the management of central or local governments and 3) joint stock companies (*công ty cổ phần*) with domestic capital, of which the state shares more than fifty per cent of charter capital.

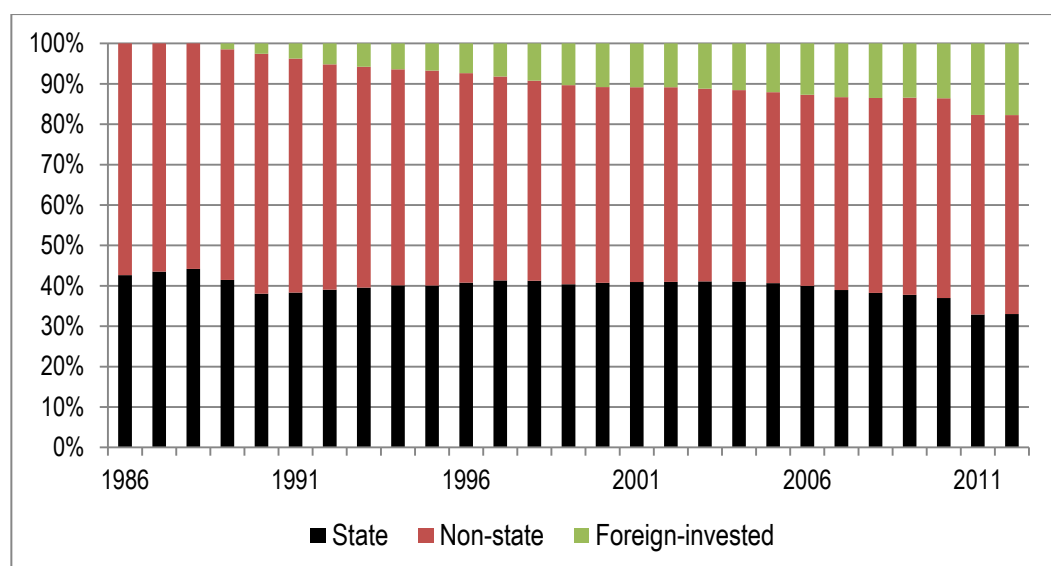
The *non-state sector* is often used to refer the ‘private sector’ (*kinh tế tư nhân*), but according to the national accounting system of Vietnam the non-state sector actually consists of three sub-sectors: collective (*kinh tế tập thể*), private (*kinh tế tư nhân*) and household (*kinh tế cá thể*).

Firms belong to the non-state sector (*Doanh nghiệp ngoài Nhà nước*) are 1) cooperatives (*hợp tác xã*), 2) private enterprises (*doanh nghiệp tư nhân*), 3) collective name companies (*công ty hợp danh*), 4) private limited companies (*công ty trách nhiệm hữu hạn tư nhân*), 5) joint stock companies which the state does not hold any charter capital and 6) joint stock companies which the state holds less than fifty per cent of charter capital.

Cooperatives were not include in the category of the non-state sector and recorded in the separate section from *Statistical Yearbook 2012*.

The household sector represents businesses which are not recognised as ‘enterprise’ by laws and regulations. The GSO of Vietnam defines ‘enterprises’ as “the economic units that independently keep business account and acquire its own legal status. They may be set up by State Enterprise Law, Cooperative Law, Enterprise Law, Foreign Investment Law or by agreements between the government of Viet Nam and foreign countries” (*Statistical Yearbook of Vietnam 2011*: 190). Finally, the foreign-invested sector includes both joint venture enterprises between Vietnam and foreign-invested enterprises and 100 per cent foreign-invested enterprises.

Figure 4: Share of GDP by type of ownership in Vietnam, 1986-2012 (at 1994 constant price)



Sources:

1. General Statistics Office of Vietnam, *Statistical Yearbook* (2001, 2005-2013), Hanoi: Statistics Publishing House.
2. General Statistics Office of Vietnam (2001). *Statistical Data of Vietnam, Socio-Economy 1975-2000*. Hanoi: Statistics Publishing House.
3. General Statistics Office of Vietnam (2007). *Statistical Data of Vietnam, Doi moi 20 Years*. Hanoi: Statistics Publishing House.

As Figure 4 shows, the state sector in Vietnam has accounted for around 38 per cent of real GDP with little variation for the last two decades.¹⁴² Is this big or small? The World

¹⁴² The General Statistics Office calculates GDP based on value-added, but also it publishes GDP data calculated based on the final expenditure approach. See, for example, pages 138-140 of *Statistical Yearbook 2012*.

Bank in its 1995 report, *Bureaucrats in Business*, measured that the weighted average share of the SOEs in economic activity in the then forty developing countries was 10.7 per cent and that of Asian countries in the sample was 10.5 per cent (World Bank 1995: 268, Table A.1).

For instance, South Korea recorded 9.9 per cent, Indonesia 14.8 per cent, Malaysia 17 per cent, Thailand 12.1 per cent and Philippines 1.7 per cent. The state sector in Vietnam is quite large compared to those Asian developing countries. Even a comparison with Taiwan, a country which achieved economic growth with an active state intervention confirms that the state sector in Vietnam is large. The state sector's share in Taiwan was 14.7 per cent in 1951, 15.9 per cent in 1961, 16.7 per cent in 1971 and 16 per cent in 1981 (Chang 2007: 11) and the weighted average was 12.1 per cent between 1978 and 1991 (World Bank *ibid.*, 269. Table A.1).

Singapore, a country which is known as has a large state sector, was likely to have a larger state sector than Vietnam does. Unfortunately, the World Bank report cited above did not include the measurement of Singapore but the Ministry of Finance of Singapore estimated that the public sector and government-linked companies (GLC's) account for about 60% of Singaporean GDP in 1993 (Singapore Ministry of Finance 1993). The share of the public sector declines in 1990s in Singapore. In 2001, the Department of Statistics of Singapore estimated that GLCs accounted for 12.9% of GDP in 1998 and the non-GLC public sector accounted for another 8.9% (Singapore Department of Statistics 2001). Therefore, the present share of the SOEs sector in the Vietnamese economy is highest in the region.

On the other hand, the comparison with the former Soviet bloc countries and China returns a very different result. The state sector in Vietnam has not been large. Before the official reunification in 1976, Vietnam ran the socialist economic system in North

Vietnam (the Democratic Republic of Vietnam) only and the state sector, called socialist sector (see Table 15, p. 145), accounted for 90 per cent. After the war against French ended in 1954, the development plan was implemented and by the end of 1960, 100 per cent of industrial establishments, 99.4 per cent of commercial establishments and 99 per cent of transportation facilities were nationalised and transformed into SOEs (Vu Quoc Ngu 2002: 3).

The size of the state sector, however, plunged to 27 per cent when South Vietnam's economy was incorporated and it increased up to 40 per cent in the mid-1990s and has remained stable (see Table 16, p. 146). The state sector in China was significantly large compared to Vietnam when *doi moi* launched (see Table 17, p. 146). Nonetheless, following the significant decline of the state sector in both in China and Vietnam over the course of reform, the two countries have shown a similar level of the state sector share.

Table 15: Structure of economic sectors in North Vietnam, 1957-1975 (per cent)

Year	Socialist sector		Total	Private, individual sector
	State-owned and state-capitalist	Collectivised and cooperative		
1957	17.9	0.2	18.1	71.9
1960	37.8	28.6	66.4	33.6
1965	44.6	45.4	90.0	10.0
1970	40.3	51.1	91.4	8.6
1975	51.7	39.9	91.6	8.4

Source: Tran Van Tho *et al.* (2000), cited in Le Dang Doanh (2009: 169).

Table 16: Structure of economic sectors in unified Vietnam, 1976-1995 (per cent)

Year	State sector	Non-state sector
1976	27.7	72.3
1980	19.8	80.2
1985	28.0	72.0
1990	31.8	68.2
1995	40.2	59.8

Source: Dang Phong (2004), cited in Le Dang Doanh (2009: 174).

Table 17: GDP share by ownership in China, 1978-2001 (per cent)

Year	State	Collective enterprises	Private
1978	77.6	22.4	0.0
1980	76.0	23.5	0.5
1985	64.9	32.1	3.0
1990	47.7	18.5	33.8
1995	42.1	20.2	37.7
1997	38.4	22.1	39.5
2000	37.3	16.5	46.2
2001	37.9	14.6	47.5

Source: Wu (2009: 35, 39)

Are SOEs inefficient? Input to and output of SOEs

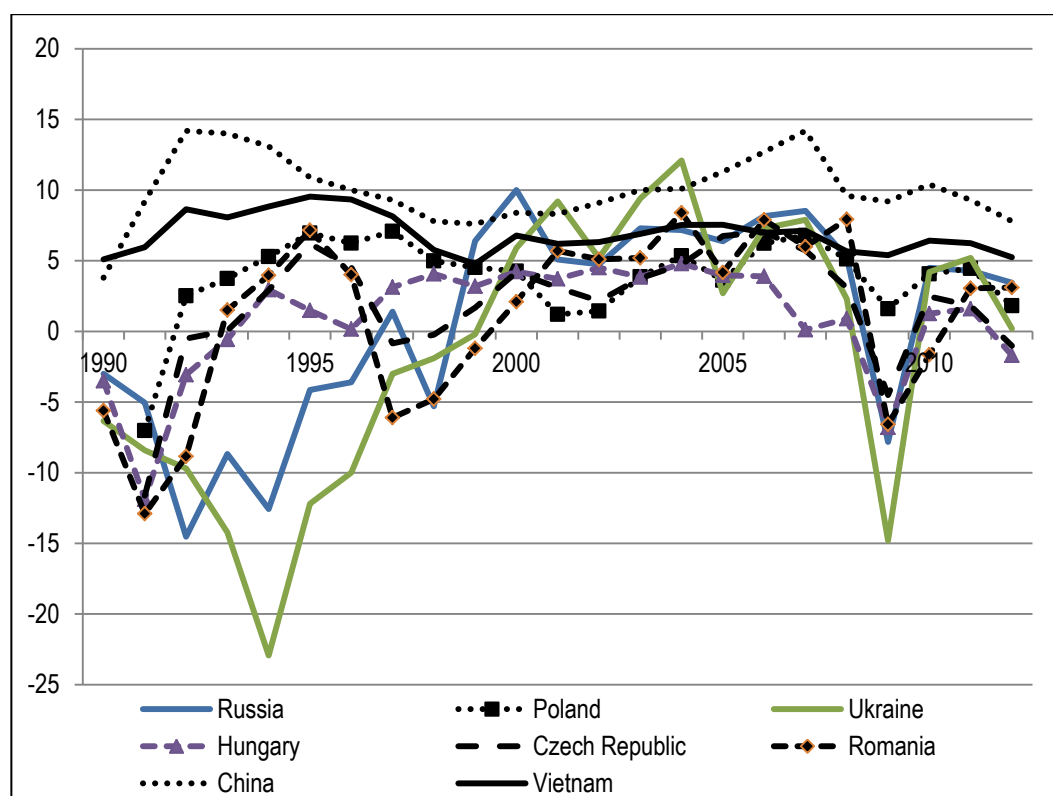
Like SOEs in other countries, SOEs in Vietnam run their businesses and also fulfil some social goals. What we often hear is that they make a loss and operate inefficiently. Can poorly performing SOEs be compatible with 6.5 per cent average annual economic growth for more than twenty years? The largest contributors to the last twenty-year's

economic growth in Vietnam were SOEs although the share of their number in the economy decreased rapidly from 13.6 per cent to 0.9 per cent over the last ten years. In spite of this fact, the World Bank attributes the economic growth of Vietnam to the introduction of market mechanism and economic liberalisation. Therefore, it recommends the Vietnamese government to reduce the significance of the state sector to achieve ‘sustainable’ economic growth in its *Vietnam Development Report 2012*, subtitled ‘Market economy for a middle-income Vietnam’ (World Bank 2012).

The experience of the former socialist economies in Eastern Europe makes us question back whether the dominance of the state sector is really a matter (see Figure 5, p. 148). The examination of the economic performance of the former Eastern European transition countries in which the introduction of market mechanism and economic liberalisation were implemented much more intensively compared to Vietnam and China make the logic of the World Bank become unconvincing. The collapse of the former Soviet bloc has naturally given rise to the question of a mode of transition. Orthodox economists suggested ‘shock therapy’ with the belief that the transition should be completed as quick as possible to benefit from the market economy and democratic political system¹⁴³.

¹⁴³ These are summarised as “... emphasizes fiscal rectitude, competitive exchange rates, privatization, undistorted market prices, and limited intervention (save for encouraging exports, education and infrastructure)” (Rodrik 1996: 9).

Figure 5: The growth rate in selected transition economies, 1990-2012 (per cent per annum)



Source: *World Development Indicators 2013*, accessed at <http://data.worldbank.org>.

As Figure 5 shows the economic performances of the former Eastern European countries have significantly different from those of China and Vietnam between 1990 and 2012, especially for the first ten years after the reform. According to Popov (2007), until 1999 no Eastern European country in his twenty-four sample countries recovered the level of GDP they recorded in 1989 and eleven countries were managed to reach this level in 2004.¹⁴⁴

According to the *Statistical Yearbook of Vietnam*, the number of SOEs has declined by 43 per cent from 5,759 to 3,239 between 2000 and 2012 of which that the number of central

¹⁴⁴ The sample countries in Popov (2007) are Poland, Slovenia, Slovakia, Uzbekistan, Czech Republic, Turkmenistan, Estonia, Belarus, Kazakhstan, Romania, Armenia, Croatia, Latvia, Bulgaria, Lithuania, Russia, Kyrgyzstan, Azerbaijan, Tajikistan, Ukraine, Georgia, Moldova.

SOEs declined 13 per cent while that of local SOEs 60 per cent (see Table 18, p. 151).¹⁴⁵

If we look at the number of SOEs in the context of the whole Vietnamese economy, the share of SOEs declined from 13.6 to 0.93 per cent during the same period. On the other hand, the share of domestic non-state enterprises increased from 82.9 to 96.2 per cent and that of foreign invested firms declined from 3.6 to 2.8 per cent during the same period because of the rapid decline in the number of joint venture companies (see Table 19, p. 152).

What is the significance of this less-than-one per cent-sharing state sector in the economy?

The GDP share of the state sector has consistently maintained around 40 per cent over the last thirty years although it fell to 35 per cent recently (see Figure 4, p. 143). Also the increase of the number of non-state enterprises does not necessarily mean the non-state sector has grown significantly. The GDP share of the non-state sector steadily remains around 50 per cent. The sector showing a significant change is the foreign-invested sector. The GDP share of this sector increase nearly zero to 13 per cent. While the number of SOEs dramatically decreased their dominance has not changed. SOEs are large in terms of the size of employees and capital (see Figure 6, Figure 7 and Figure 8, p. 150).

¹⁴⁵ Many of enterprises data displayed in this chapter available from 2000 only. Some enterprise data available before 2000 are number of enterprises by ownership type, by province etc. in *Vietnam Statistical Data in the 20th Century* published by the General Statistic Office of Vietnam in 2004. This is why the time span of many of demonstrated data is last 12 years.

Figure 6: Number of employees in the state sector (biennial, 2001-2011)

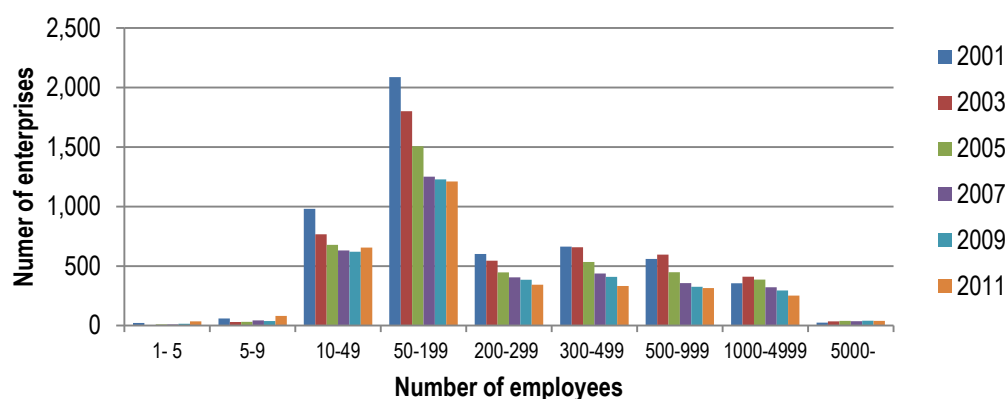


Figure 7: Number of employees in the non-state sector (biennial, 2001-2011)

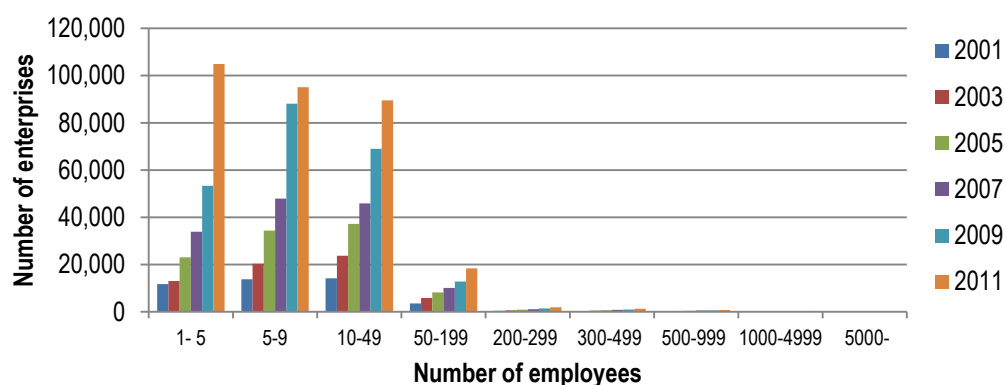
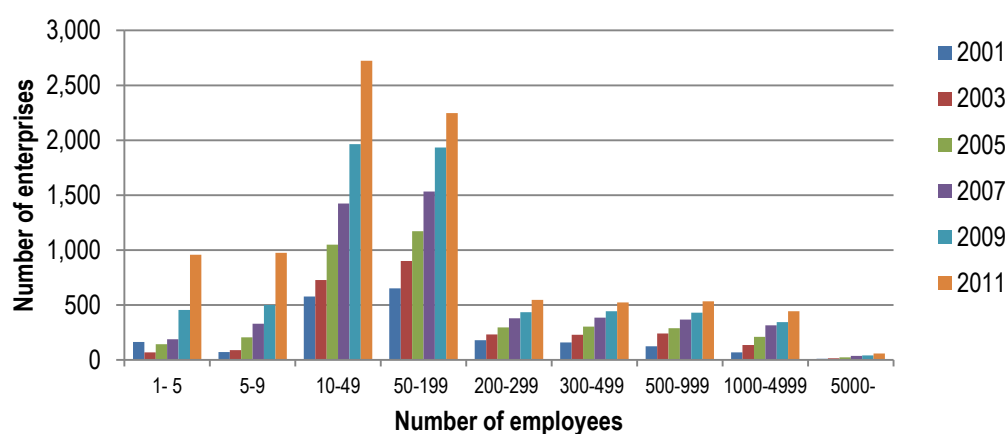


Figure 8: Number of employees in the foreign-invested sector (biennial, 2001-2011)



Sources:

1. General Statistics Office of Vietnam (2013). *Development of Vietnam Enterprises in the period of 2006-2011*. Hanoi: Statistics Publishing House.
2. General Statistics Office of Vietnam (2010). *Enterprises in Vietnam at the Beginning of Century 21*. Hanoi: Statistics Publishing House.

We may argue that the partial privatisation of SOEs, called *equitisation (co phan hoa)* in Vietnam, can explain the decrease in the number of SOEs. It is true that the number of joint-stock companies (JSCs) having state capital increased by 1,256 from 305 to 1761 between 2000 and 2012. During the same period, the number of SOEs decreased by 2,494 (see Table 18 below). Reminding that SOEs include JSCs having state capital more than 50 per cent, the rest 1,238 SOEs have been restructured from 100 per cent state-owned to more than 50 per cent state-owned enterprises through the equitisation.

Table 18: Number of SOEs in Vietnam, 2000-2012

Year	State enterprise (total)	Central	Local
2000	5,759	2,067	3,692
2001	5,355	1,997	3,358
2002	5,363	2,052	3,311
2003	4,845	1,898	2,947
2004	4,597	1,968	2,629
2005	4,086	1,825	2,261
2006	3,706	1,744	1,962
2007	3,494	1,719	1,775
2008	3,328	1,669	1,659
2009	3,364	1,805	1,559
2010	3,283	1,777	1,506
2011	3,265	1,797	1,468
2012	3,239	1,792	1,447
Change	-2,494 (43.3%)	-270 (13.1%)	-2,224 (60.2%)

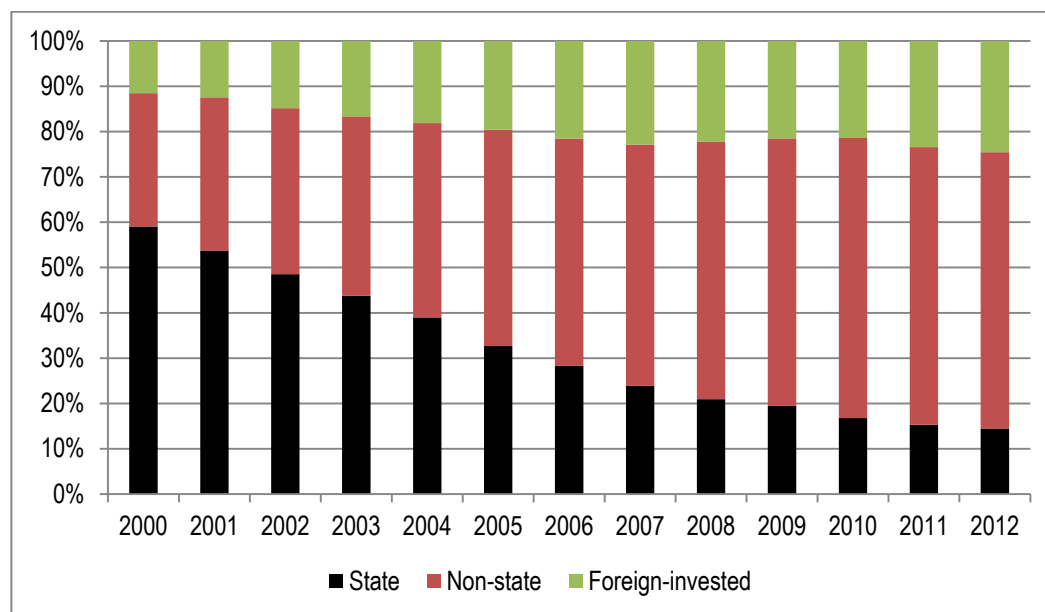
Sources: General Statistics Office of Vietnam, *Statistical Yearbook* (2005 – 2013). Hanoi: Statistics Publishing House.

Table 19: Share of enterprises by ownership in Vietnam, 2000-2011 (per cent)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
State owned enterprise	13.62	10.36	8.53	6.73	5.01	3.62	2.82	2.24	1.62	1.35	1.13	1.01	0.93
Central	4.89	3.86	3.26	2.64	2.14	1.62	1.33	1.10	0.81	0.73	0.61	0.55	0.51
Local	8.73	6.50	5.26	4.09	2.87	2.00	1.49	1.14	0.81	0.63	0.52	0.45	0.42
Non-state enterprise	82.78	85.75	87.81	89.60	91.55	93.11	93.96	94.57	95.65	96.02	96.38	96.22	96.48
Collective	7.65	7.05	6.52	5.76	5.83	5.61	4.74	4.29	6.58	4.92	4.09	4.11	3.77
Private	48.59	44.07	39.41	35.62	32.67	30.67	28.42	25.98	22.62	19.22	16.48	15.06	13.88
Collective name	0.01	0.01	0.04	0.02	0.02	0.03	0.02	0.03	0.03	0.03	0.03	0.06	0.09
Limited Company	24.73	31.52	37.33	41.89	44.59	46.49	48.48	49.85	50.11	54.01	56.29	59.53	60.87
Joint stock company having capital of the state	0.72	0.91	0.89	0.93	0.89	0.97	1.04	1.03	0.88	0.70	0.59	0.54	0.51
Joint stock company without capital of the state	1.07	2.18	3.61	5.38	7.54	9.34	11.27	13.39	15.43	17.13	18.90	21.03	21.13
Foreign investment enterprise	3.61	3.89	3.67	3.67	3.44	3.27	3.21	3.18	2.73	2.63	2.49	2.77	2.59
100% foreign capital	2.02	2.50	2.48	2.60	2.54	2.53	2.54	2.58	2.24	2.17	2.06	2.31	2.17
Joint venture	1.59	1.39	1.19	1.07	0.89	0.75	0.67	0.61	0.49	0.46	0.43	0.46	0.42
Total (%)	100	100	100	100	100	100	100	100	100	100	100	100	100

Sources: General Statistics Office of Vietnam, *Statistical Yearbook* (2005 – 2013), Hanoi: Statistics Publishing House.

Figure 9: Share of employees of enterprises by ownership (2000-2012)



Sources: General Statistics Office Vietnam, *Statistical Yearbook* (2005 – 2013). Hanoi: Statistics Publishing House.

How much resources these SOEs have consumed in their business operation while the number of SOEs declined largely and the share of its number fell below 1 per cent over the reform and equitisation?

Labour

Figure 9 above shows that share of workers employed in SOEs has largely decreased from 59 per cent in 2000 to 14.5 per cent in 2012 due to the state sector reform, which decreased the number of employees by 23 per cent from 2 million in 2000 to 1.6 million in 2012. This sharp decrease of the share of employees is due to surge of the number of workers employed in the non-state sector. It increased by 570 per cent from one million in 2000 to 6.7 million in 2012. The majority of them were hired by private limited liabilities and JSCs having no state capital. In 2012, for example, while the non-state sector's employment accounted for 60.97 per cent as a while, the number workers employed in the two groups recorded 51.7 per cent which was equivalent to 84.8 per cent of total non-state sector employment.

It is frequently attacked that the share of employees in SOEs is small compared to its size (for example, Matheson 2013, World Bank 2012). However, this criticism is unfair. First of all, the organisations which criticise that the growth of employment in the state sector is slower than the private sector have recommended reforming SOEs by decreasing their dominance. This is no fair. Secondly, given that the number of SOEs accounts for just below one per cent in the economy, nearly 15 per cent of employment cannot be considered as an indicator showing the weakness of SOEs in maintain employment. If we calculate the number of workers per enterprise, SOEs hire the largest number of workers per enterprise while the non-state sector hires incomparably small number of workers except JSCs having state capital (see Table 20 below). Pham Quang Ngoc and Mohnen (2012: 22) argue that the privatisation has not contributed to increase welfare in terms of creating more jobs but state sector has contributed to maintain employment.

Table 20: Number of employees per enterprise (biennial, 2000-2012)

	2000	2002	2004	2006	2008	2010	2012
TOTAL	84	74	63	51	40	35	32
SOEs	363	421	490	513	518	514	496
Central	630	704	771	787	780	733	665
Local	213	246	279	268	255	257	287
Non-state	30	31	29	27	24	22	20
Private	12	14	14	13	12	13	11
Private Limited Co.	49	39	34	27	22	19	16
JSCs having state capital	203	259	226	270	276	295	270
JSCs having no state capital	96	62	44	41	36	32	31
Foreign invested	267	299	331	343	325	297	303

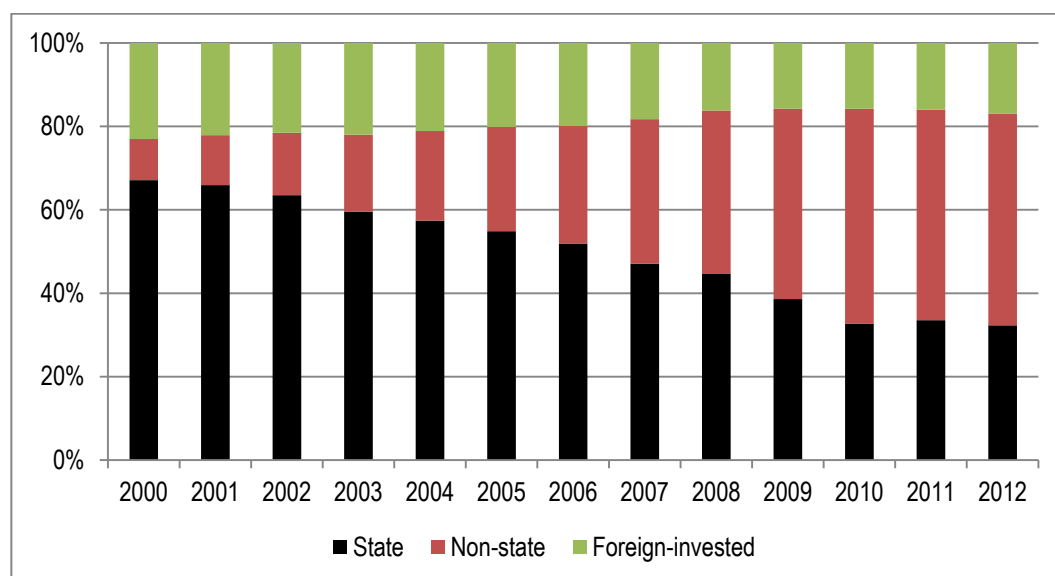
Sources: General Statistics Office Vietnam, *Statistical Yearbook* (2005 – 2013). Hanoi: Statistics Publishing House.

Capital

A similar pattern to the number of employees is found in regard to both working capital and fixed capital and long-term investment (see Figure 10 and Figure 11, p. 156). The share of working capital used by SOEs in the economy decreased from 67 per cent in 2000 to 32 per cent in 2012 while that used by the enterprises in the non-state sector increased from 9.8 per cent to 50.8 during the same period. The majority of increase of working capital used in the non-state sector occurred in both private limited companies and JSCs having no state capital.

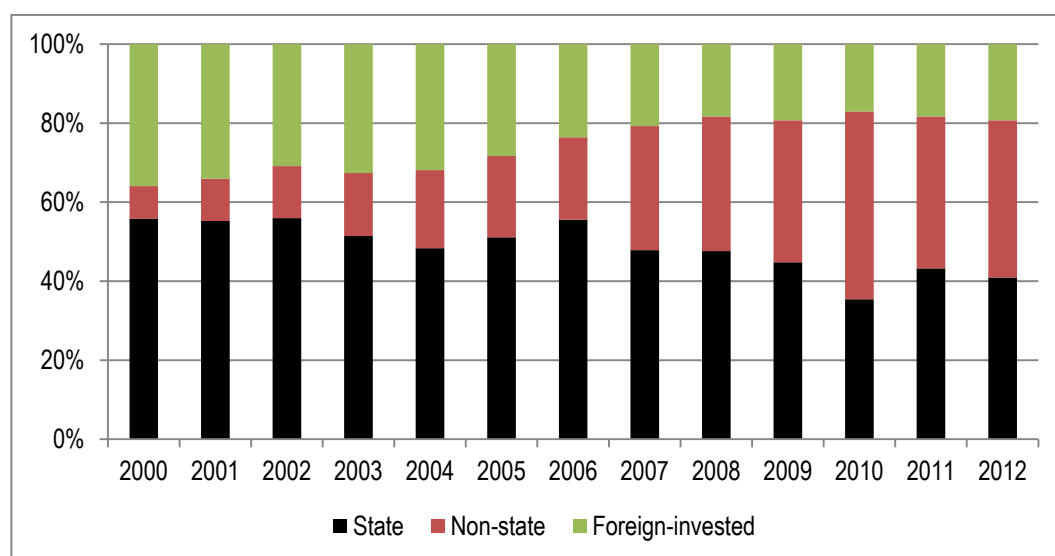
While the proportion absorbed by the state sector has declined, the amount of government-subsidised credit to SOEs which includes ODA on-lending via Vietnam Development Bank, other credit of Vietnam Development Bank and external borrowing has risen sharply from VND 40 trillion in 2001 to VND 275 trillion in 2011 which accounts from 6 per cent and 11 per cent of GDP respectively (Matheson 2013).

Figure 10: Share of working capital of enterprises by ownership (2000-2012)¹⁴⁶



Sources: General Statistics Office of Vietnam, *Statistical Yearbook* (2005 – 2013). Hanoi: Statistics Publishing House.

Figure 11: Share of fixed assets and long-term investment of enterprises by ownership (2000-2012)



Sources: General Statistics Office of Vietnam, *Statistical Yearbook* (2005 – 2013). Hanoi: Statistics Publishing House.

¹⁴⁶ The Vietnamese term for this data is “*vốn sản xuất kinh doanh*” and its translation in English in the Statistical Year Book is just “capital” (see page 133 of the *Statistical Year Book 2005* for example). The literal translation of “*vốn sản xuất kinh doanh*” is business capital which is used to refer to ‘working capital’ in Vietnam. In international context, this refers short-term financial capital which is used for the running of business. Accordingly, there is a separate section showing “long-term investment” statistics in the *Statistical Year Book*.

The fixed of asset held by SOEs and their long-term investment account for 55.8 per cent in 2000 while those of the non-state sector recorded 8.2 per cent only. The decline in this indicator is not as discernible as in the case of working capital but the share of SOEs declined to 41 per cent in 2012 while that of the non-state sector increased to 40 per cent in the same year after it reached the peak at 47.6 per cent in 2010. The size of the fixed asset and long-term investment in the state sector and in the foreign-invested sector increased by 10 times and by 8 times each between 2010 and 2012 while it surged 71.5 times in the non-state sector during the same period. Particularly, JSCs having no state capital recorded 376 times increase for this indicator.

Table 21: Amount of working capital used per enterprise (biennial, 2000-2012, billion VND)

	2000	2002	2004	2006	2008	2010	2012
TOTAL	23.6	21.5	21.4	23.1	29.8	36.7	43.8
SOEs	116.4	160.1	245.6	425.2	824.2	1,063.8	1,515.4
Central	279.6	357.7	492.3	796.3	1,469.5	1,795.7	2,491.1
Local	25.0	37.6	60.9	95.4	175.0	200.3	307.0
Non-state	2.8	3.7	5.0	6.9	12.2	19.6	23.1
Private	0.8	1.1	1.4	2.2	3.2	6.7	6.2
Private Limited Co.	4.3	4.2	5.0	5.7	7.7	12.7	12.6
JSCs having state capital	34.2	70.2	94.5	120.5	259.7	474.6	582.0
JSCs having no state capital	43.6	11.8	12.3	15.5	29.6	40.5	51.0
Foreign invested	150.7	126.1	131.4	143.3	176.6	232.6	286.3

Sources: General Statistics Office Vietnam, *Statistical Yearbook* (2005 – 2013). Hanoi: Statistics Publishing House.

Table 22: Amount of fixed capital and long-term investment per enterprise (biennial, 2000-2012, billion VND)

	2000	2002	2004	2006	2008	2010	2012
TOTAL	9.7	8.8	8.1	10.9	13.7	15.5	17.6
SOEs	39.9	57.6	78.3	214.3	402.8	487.9	770.9
Central	89.7	121.8	143.6	399.2	718.7	813.3	1,269.8
Local	12.0	17.9	29.4	49.9	84.9	103.9	152.9
Non-state	1.0	1.3	1.8	2.4	4.9	7.7	7.2
Private	0.8	1.1	1.4	2.2	3.2	6.7	6.2
Private Limited Co.	1.5	1.6	1.9	2.1	3.1	5.4	4.0
JSCs having state capital	9.7	17.8	26.0	34.1	84.5	104.9	136.3
JSCs having no state capital	7.4	3.6	3.7	5.8	13.0	17.0	17.2
Foreign invested	97.0	73.9	75.2	79.9	91.6	106.2	131.0

Sources: General Statistics Office Vietnam, *Statistical Yearbook* (2005 – 2013). Hanoi: Statistics Publishing House.

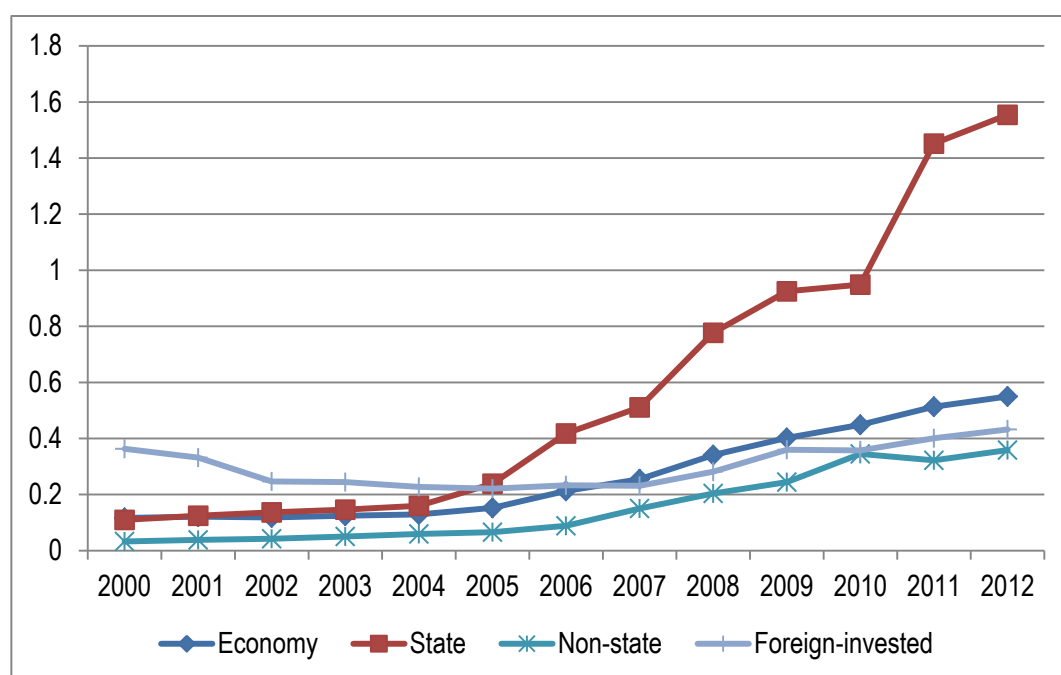
Per enterprise data show that SOEs heavily use capital or they operate in capital-intensive businesses (see Table 21 and Table 22 above). Working capital spent by an SOE was VND 1,515 billion while a non-state enterprise spent VND 23 billion in 2012, and the amount of fixed capital and long-term investment of an SOE was 1,269 billion whereas a non-state enterprises' fixed capital and long-term investment reached just 7.2 billion. One of remarkable note is that the amount of fixed capital consumed by a JSC having state capital was very large given that the number of JSCs having state capital is handful (see Table 19, p. 152). It was VND 136 billion in 2012 which was even larger than the amount consumed by a local SOE. This implies that the dominance of state capital still continues even after partial privatisation.

The capital equipment ratio also confirms that the state sector is highly capital-intensive compared to other sectors including the foreign-invested sector (see Figure 12 below).

The capital equipment ratio in the state sector outpaced since 2005. Particularly, the capital equipment ratio in central SOEs recorded 1.9 in 2012 while that in local SOEs was just 0.53 in the same year which was very close to the average of the economy.

However, the productivity of this capital intensive state sector has been questioned. For example, Dapice (2003: 5) argues that “there has been a growing share of total investment being directed by the public sector. If relatively inefficient infrastructure and poorly chosen heavy industry account for a larger share of capital formation, it would not be surprising if this were reflected in higher capital “requirements” to produce an equal increment of growth”.

Figure 12: Capital equipment ratio per work (2000-2012)



Sources: General Statistics Office Vietnam, *Statistical Yearbook* (2005 – 2013). Hanoi: Statistics Publishing House.

Net turnover

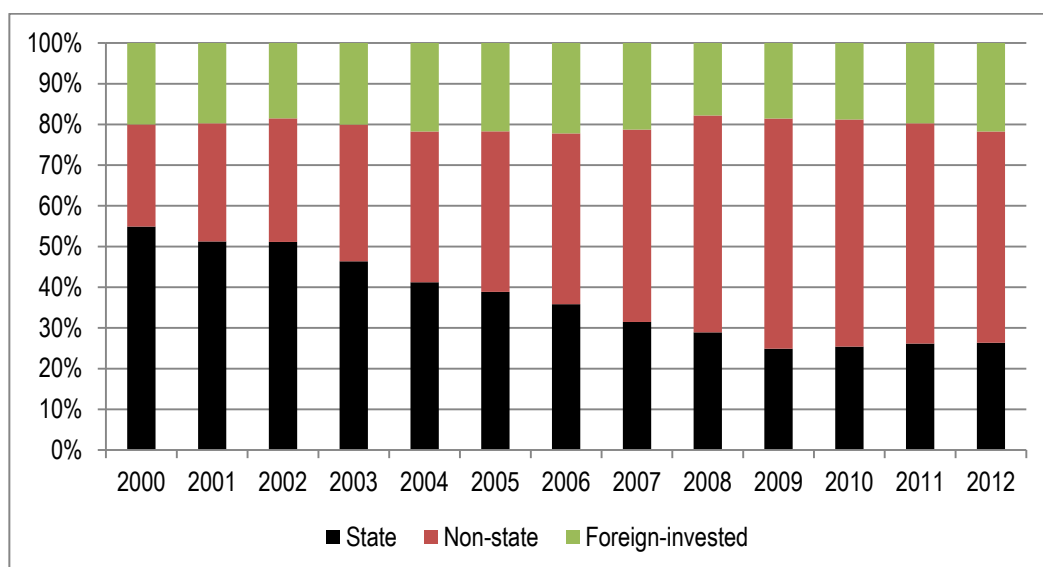
We have examined that the state sector consumes large amount of resources. Does its output commensurate with its input consumption? Net turnover and profit rate data indicate that we may have exaggerated the inefficiency of the Vietnamese state.

The share of net turnover recorded by SOEs declined from 55 per cent to 26.3 per cent between 2000 and 2012 and that of the non-state enterprises increased from 25 per cent to 52 per cent during the same period (see Figure 13, p. 161). Nonetheless, the amount of net turnover per work reveals that the state sector outperforms both the non-state and the foreign-invested sector. While each worker contributes VND 1.8 billion in the state sector, a worker in the non-state sector and in the foreign-invested sector does VND 0.85 billion and VND 0.9 billion each (see Figure 14, p. 161).

Profit

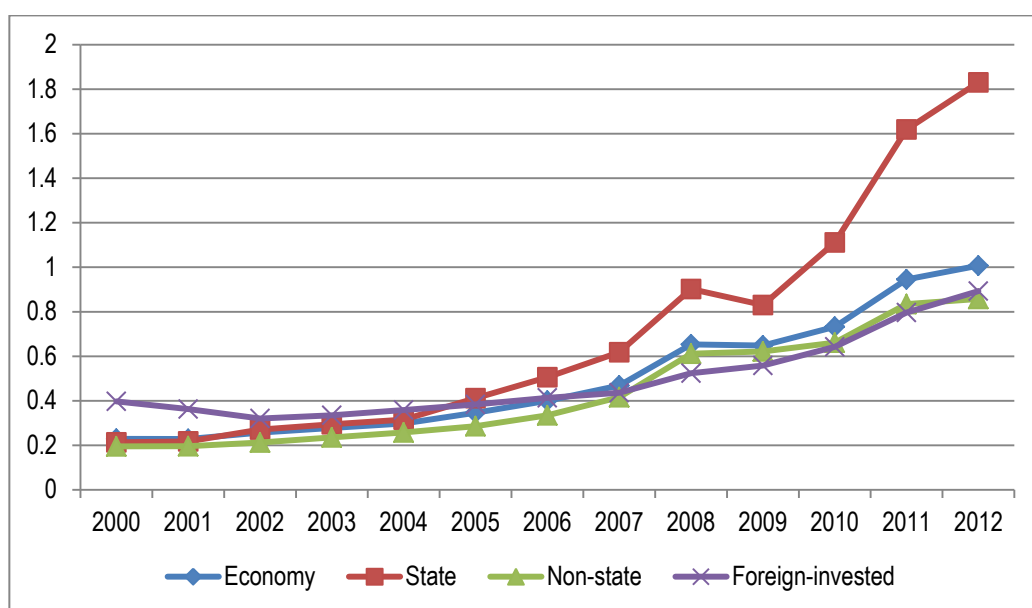
How many SOEs have performed badly? There has also been a bad perception that SOEs are not profitable. For examples, it was reported that statistics from Ministry of Finance shows that three fifths of SOEs were unprofitable as of the end of 1997 (World Bank 1998: 9); for 1999 only 40 per cent of SOEs can make profits (*Lao Dong* newspaper 23 May 2000 (cited in Vu Quoc Ngu 2002: 9)).

Figure 13: Share of net turnover of enterprises by ownership (2000-2012)¹⁴⁷



Sources: General Statistics Office of Vietnam, *Statistical Yearbook* (2005 – 2013). Hanoi: Statistics Publishing House.

Figure 14: Net turnover per worker (2000-2012, billion VND)



Sources: General Statistics Office of Vietnam, *Statistical Yearbook* (2005 – 2013). Hanoi: Statistics Publishing House.

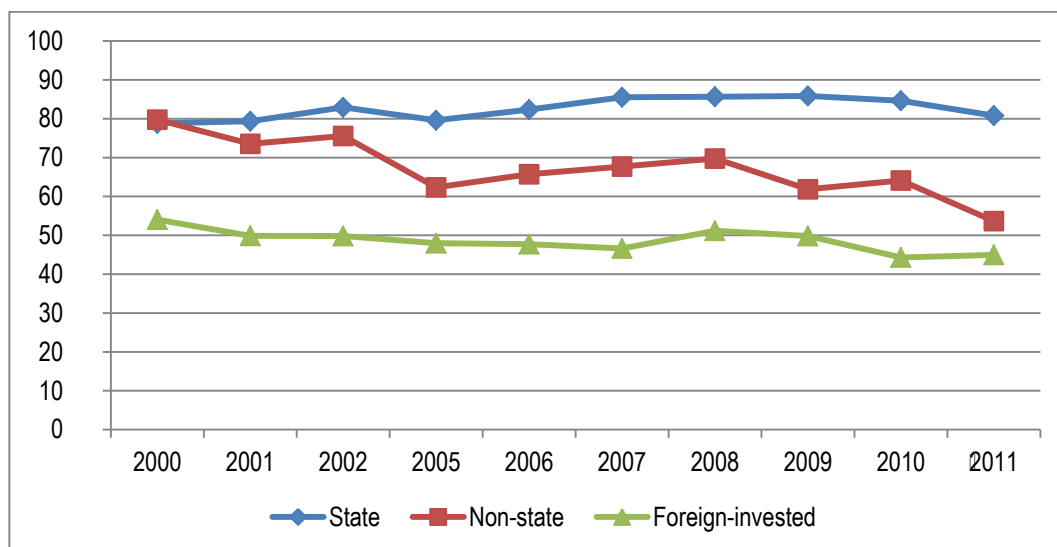
¹⁴⁷ Net turnover is defined as the “total income of enterprise gained by selling its products or services after subtracting taxes (special selling tax, export tax, value added tax by method of payable direct) and other reduction (discounting, reducing selling price, returning goods). Net turnover does not include: (1) Turnover gaining by financial activity (except lending asset with its controller); (2) Turnover gaining by special activity such as: selling off asset, getting money due to partner violates contract, getting money from bad debt that was processed...” (*Statistical Yearbook 2005*: 114).

Nonetheless, the profitability has improved since 2000. The number of gainers and losers reveals that the proportion of SOEs making a profit has been around 80 per cent.¹⁴⁸ The performance of the non-state enterprises has worsened over the last twelve years (see Figure 15, p. 163). It may be useful to calculate the ratio of the gross amount of gain to that of loss because it can measure whether the profit which SOEs make is sensibly large or negligible compared to the amount of loss (see Figure 16, p. 163). The ratios ranged from 6 to 13 if we ignore the two years (2007 and 2009) in which the ratio was extremely high. The ratios in the non-state sector recorded below 5 except 2007 and those in the foreign-invested sector varied from 3 to 10. The size of profits in the state sector has fairly been large compared to the non-state and the foreign-invested sector.

However, the ratio of ‘average’ gain to ‘average’ loss which is calculated by dividing total gain (loss) by the number of gainers (losers) indicates a different trend (see Figure 17, p. 164). The ratios in the foreign-invested sector which ranged between 2.5 to 9 have outperformed the other two sectors. The ratios in the state sector varied from 1 to 2.3 if we ignore the extremely high ratio in 2007 and 2009. The data implies that the size of loss made by the 20 per cent loss-making SOEs is significantly large compared to loss-making enterprises in the non-state and the foreign-invested sector. It is an exaggeration to say that SOEs are inefficient in general, but it is also true that the loss-making SOEs in Vietnam had made a large amount of loss. Matheson (2013) demonstrates that SOEs exhibit a wide range of profitability. Viettel (telecommunication), Vinarubber (rubber), Vinacomin (coal and mining) are highly profitable with low debt while EVN (electricity), Saigon Construction and Water Construction suffer loss after loss.

¹⁴⁸ See Table A3 (p. 238) in Appendix for full information of gainers and losers for the period 2000-2002 and 2005-2011.

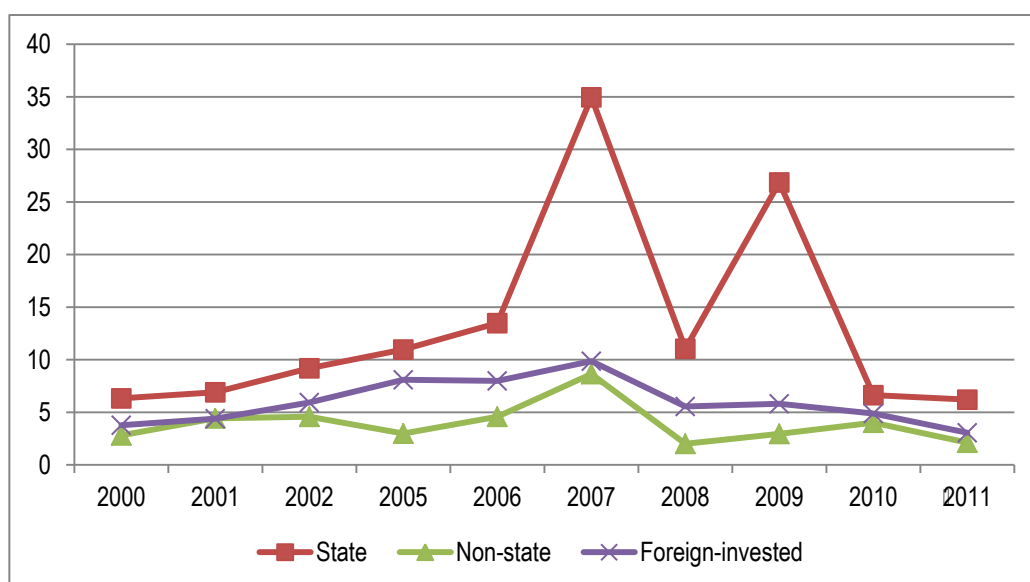
Figure 15: Proportion of profit making enterprises (2000-2002, 2005-2011, per cent)



Sources:

1. General Statistics Office of Vietnam (2013), *Development of Vietnam Enterprises in the Period of 2006-2011*. Hanoi: Statistics Publishing House.
2. General Statistics Office of Vietnam (2009), *The Situation of Enterprises through the Results of Surveys Conducted in 2006, 2007, 2008*. Hanoi: Statistics Publishing House.
3. General Statistics Office of Vietnam (2004), *Industrial Complete Survey 2001-2003*. Hanoi: Statistics Publishing House.

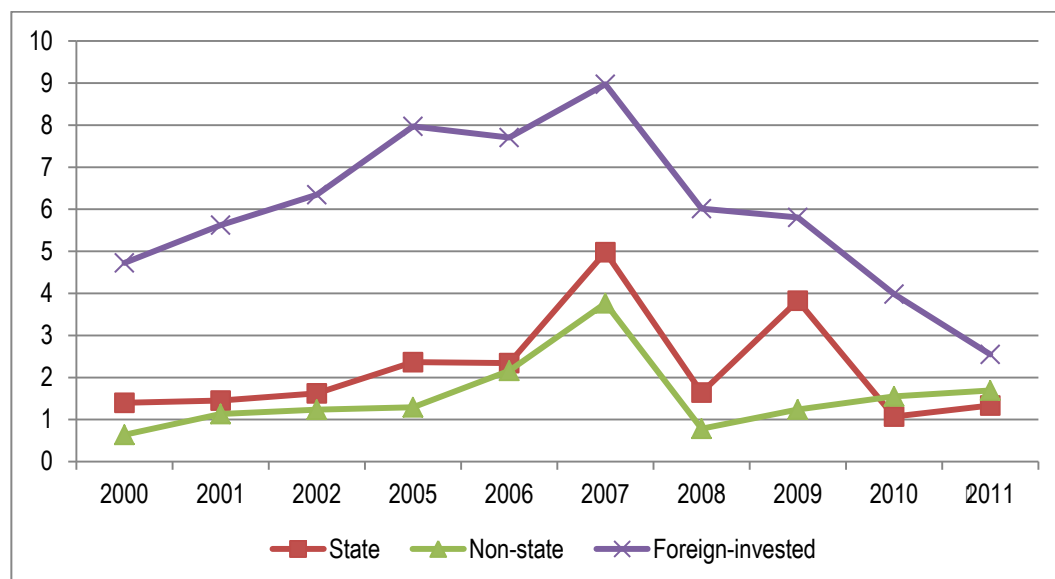
Figure 16: Ratio of gross gain to gross loss (2000-2002, 2005-2011)



Sources:

1. General Statistics Office of Vietnam (2013), *Development of Vietnam Enterprises in the Period of 2006-2011*. Hanoi: Statistics Publishing House.
2. General Statistics Office of Vietnam (2009), *The Situation of Enterprises through the Results of Surveys Conducted in 2006, 2007, 2008*. Hanoi: Statistics Publishing House.
3. General Statistics Office of Vietnam (2004), *Industrial Complete Survey 2001-2003*. Hanoi: Statistics Publishing House.

Figure 17: Ratio of average gain to average loss (2000-2002, 2005-2011)

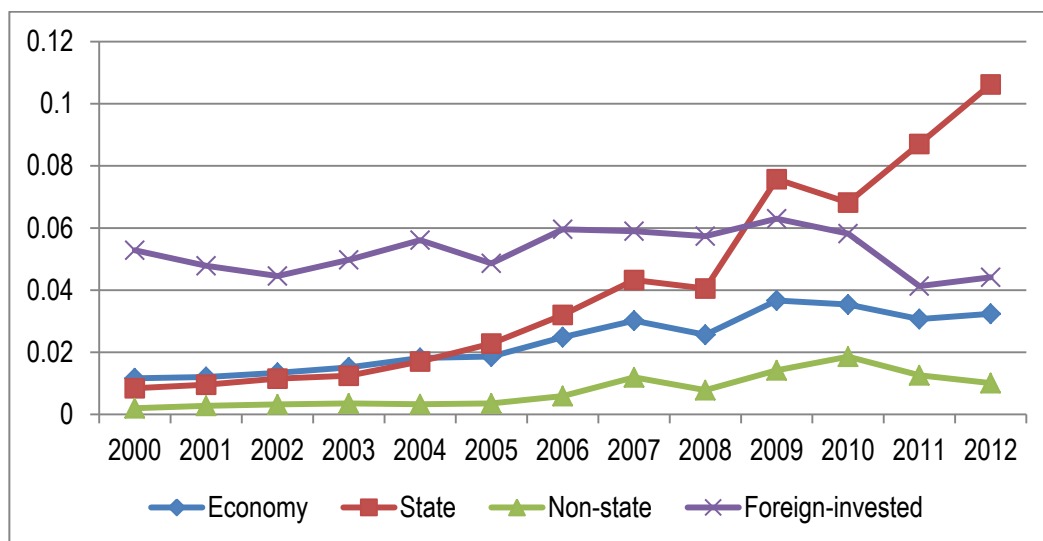


Sources:

1. General Statistics Office of Vietnam (2013), *Development of Vietnam Enterprises in the Period of 2006-2011*. Hanoi: Statistics Publishing House.
2. General Statistics Office of Vietnam (2009), *The Situation of Enterprises through the Results of Surveys Conducted in 2006, 2007, 2008*. Hanoi: Statistics Publishing House.
3. General Statistics Office of Vietnam (2004), *Industrial Complete Survey 2001-2003*. Hanoi: Statistics Publishing House.

In regard to profit before tax, the foreign-invested sector outperformed until 2008 but the state sector took over the place from 2009 and the gap between of the two sectors has widened (see Figure 18, p. 165). In 2012, each worker in the state sector created the profit of VND 106 million while each worker in the non-state sector and in the foreign-invested sector did VND 10 million and VND 44 million respectively.

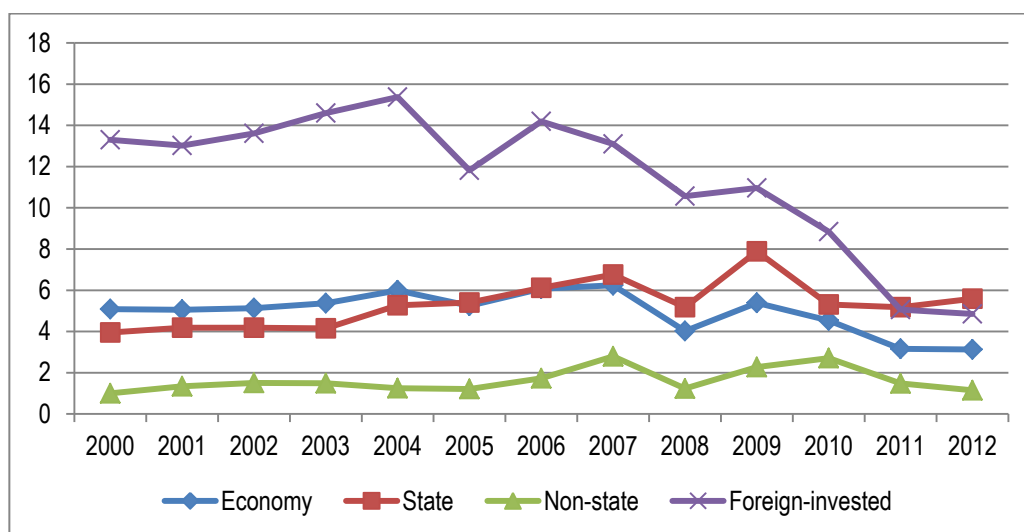
Figure 18: Profit before tax per worker (2000-2012, billion VND)



Sources:

1. General Statistics Office of Vietnam, *Statistical Yearbook* (2012 and 2013). Hanoi: Statistics Publishing House.
2. General Statistics Office of Vietnam (2010), *Enterprises in Vietnam at the Beginning of Century 21*. Hanoi: Statistics Publishing House.

Figure 19: Rate of profit of enterprises by ownership (2000-2012)¹⁴⁹



Sources:

1. General Statistics Office of Vietnam, *Statistical Yearbook* (2012 and 2013). Hanoi: Statistics Publishing House.
2. General Statistics Office of Vietnam (2010), *Enterprises in Vietnam at the Beginning of Century 21*. Hanoi: Statistics Publishing House.

¹⁴⁹ The profit rate used here is ‘profit rate per net turnover’, which is the ratio “between total profit before tax gained by production, financial activities and other activities of enterprises during a year and total turnover gained by selling goods, service and other income of enterprises during a year” (General Statistics Office of Vietnam 2010: 26).

The rate of profit per net turnover confirms that the state sector has improved. The rate profit was considerably high in the foreign-invested sector compared to the domestic sector. In 2000 the profit rate in the foreign-invested sector was 13.3 per cent while that in the state sector was around 4 per cent only. However, the rate of profit in the foreign-invested sector aggravated continuously whereas that in the state sector gradually improved. Finally they switched their position in 2012 when the state sector recorded 5.6 per cent of profit rate and the foreign-invested sector did 4.8 per cent of profit rate. The rate of profit in the non-state sector has been sluggish with some variation. It fluctuated between 2007 and 2010 but shows a tendency of decline over the last two years. The rate of profit was 1.15 per cent in 2012 while it was one per cent in 2000.

5. Methodology

The majority of qualitative primary data used in this dissertation were collected by the author during his stay in Vietnam from April to November 2005. The field interviews with SOEs and local officials were conducted twice in Hai Phong City¹⁵⁰, the largest northern seaport city, in August 2005 and October 2005.¹⁵¹ The interview trips were funded and organised by UNDP Vietnam.

The interviews were conducted to confirm the result of Gainsborough (2005). In order to collect the information from SOEs operating in a local area, we had to pick a city which shows decent economic dynamism and also has enough number of SOEs. Hai Phong City met these conditions. Furthermore, it was the closest and the largest local city near Hanoi where the working station of the research team, UNDP Vietnam, was located. It was relatively easier not only for the research team but also for UNDP Vietnam to arrange several-days interview trips to Hai Phong City which is in two and a half hours driving distance from Hanoi.¹⁵²

While the interviews were conducted in two trips, the number of interviewed SOEs was twenty-two which might look small and the location was limited to one city. One problem

¹⁵⁰ Hai Phong City is about 120 km away from Hanoi towards Eastern coast line of Vietnam. It has around 1.8 million people within the area of 1,526 km² with its fourteen districts. It is one of the most dynamic economic zones in northern Vietnam following the Hanoi region. GDP per capita was USD962.2 in 2004 while that of the national average was USD514 in the same year. The average annual growth rate between 2000 and 2004 was 10 per cent. Over the same period, the industrial sector contributed 36.2 per cent to GDP, the service sector 49.5 per cent and the agriculture, forest and fishery 14.2 per cent. The state sector shares 38 per cent of output whereas the non-state sector and the foreign sector 44 per cent and 16 per cent of output share respectively (Hai Phong Statistics Office 2005).

¹⁵¹ The research team was comprised of Scott Cheshier and Jago Penrose and the author himself with Vietnamese researchers, Mr. Bui Truong Giang and Ms. Nguyen Thi Thanh Nga.

¹⁵² It also might be easier for UNDP Vietnam to arrange visits to SOEs in Hai Phong City because of its friend relationship to the Vietnam Association of Social Science (VASS) which is an implicit helper of the interview trips.

which is common in every research project was that the team encountered financial and time constraints. Second difficulty resulted from the fact that the interviews were conducted with ‘state-owned’ enterprises. SOEs are government organs and the arrangement of visits entailed considerable difficulty. These two facts can explain why the interview was conducted in one local city with limited number of SOEs.

Data collection

The interviews were conducted in English by the research team with the help of a Vietnamese researcher who took the role of an interpreter. Some interviewees were able to speak English or bring their own interpreters. The questionnaire which drew on the set used in Gainsborough (2005) was sent to listed SOEs in advance and collected on actual visits. Returned questionnaires were translated into English.

The questionnaire for SOEs was designed to capture the information on five areas.¹⁵³

- i) the general business environment (section A and B);
- ii) the relationship between SOEs and the local authorities and how it evolved (section C);
- iii) the finance such as access to bank loans and sources of investment (section D);
- iv) the autonomy of SOEs in decision makings and the perception of bailouts by the state (section E); and
- v) closing questions about the personal background of the interviewees (section F).

The questionnaire for local officials was sent in advance as well. It was structured in such a way as to gain an understanding of the relationship between the local authorities and SOEs. Questions asked whether the local authorities were entwined with daily management of SOEs including business plans and personnel issues and how the relations

¹⁵³ For a sample questionnaire see Table A5 (page 240) in Appendix.

have changed along with economic reform.¹⁵⁴ The research team had interviews with several officials from three local departments (the Department of Industry, the Department of Planning and Investment and the Department of Finance) during the same fieldwork trips.

In addition to the qualitative data from the interviews, the author collected Vietnamese legal documents translated into English with the help of the United Nations Development Programme (UNDP) Vietnam. Some of them are barely accessible from abroad.

Apart from the data collected in Vietnam, the author gathered secondary data from the translated Vietnamese media which was held in the library of the School of Oriental and African Studies (SOAS). These include the *BBC Summary of World Broadcast* (BBC SWB), *Foreign Broadcast Information Services Daily Report* (FBIS), *Joint Publications Research Services Report* (JPRS) and *Vietnam Couriers*.

Selection of SOEs

There were 4,596 SOEs of which 1,967 were centrally-managed SOEs and 2,629 were locally-managed SOEs at the national level as of 2004. In Hai Phong, there were 199 SOEs of which 84 were centrally-managed SOEs and 115 were locally-managed SOEs. The number of SOEs accounts for around 4 per cent. The state sector in Hai Phong contributed 50 per cent of local domestic output, hired 14 per cent of employees and its contribution to the local budget was 32.3 per cent of domestic revenue as of 2004 (Hai Phong Statistics Office 2005). The twenty-two SOEs were selected from the *Enterprise Survey 2004* published by the General Statistics Office of Vietnam (GSO) in consultation with local officials because it was required to get a kind of approval in advance from the local authority before commencing the interviews. The consultation was done with local

¹⁵⁴ For a sample questionnaire, see Table A6 (page 247) in Appendix.

officials from the Department of Planning and Investment of Hai Phong City. However, this does not necessarily lead to a presumption that the local government intentional picked up sample SOEs.

Among these twenty-two SOEs, thirteen firms were locally managed SOEs (*doanh nghiep nha nuoc tai dia phuong*) of which three were equitised to become joint stock companies (*cong ty co phan*); nine firms were centrally managed SOEs (*doanh nghiep nha nuoc trung uong*) of which one was equitised SOE. Interviewed SOEs were scattered in various sectors but no firm conducted business in the agriculture, forestry or fishery sector (see Table 23, p. 171). Most of the interviewees were either the director or the vice director or a member of the board of management of interviewed SOEs. As of June 2014, none of the interviewed SOEs closed and seven of them were equitised of which three were locally-managed SOEs and four were centrally managed SOEs (see Table 26, p. 173 for more detail information on interviewed SOEs).

The national average pattern that central SOEs are bigger than local SOEs, which we examined in Chapter 4 found in Hai Phong as well. Average size of capital was VND 306.2 billion (equivalent to USD 19.6 million), average turnover was VND 342.3 billion (equivalent to USD 21.9 million) and average number of workers employed was 1,650. In terms of capital size and the number of workers most of them belong to the category of 'large' firms. In general, central SOEs are bigger than local SOEs on average in terms of size of capital and the number of workers. Nonetheless, two local SOEs producing footwear hired 2,500 and 9,972 worker each.

Following the Vietnamese regulation, four SOEs fall into small enterprises, seven into medium and nine into large in terms of the size of capital as shown in Table 24 (p. 172). While only one central SOE was an SME, ten local SOEs were SMEs. In terms of the number of employees, two SOEs fall into small enterprises, one into medium and

eighteen into large. No central SOE was in SME but three local SOEs were SMEs in terms of the number of workers.

Table 23: Summary of interviewed SOEs

Company	Local / Central*	Business area	Capital (bil. VND)	Turnover (bil. VND)	No. of workers
A	Local	Utility	473	105.4	785
B	Local/JSC	Construction	45	18	395
C	Local	Steel	70	0.2	70
D	Local	Design and construction	40	89	205
E	Local	Tobacco	91	453	134
F	Local	Export/Import	307	559	856
G	Local/JSC	Engineering	85	90	203
H	Local	Construction	5	30	315
I	Local/JSC	Construction	20	100	300
J	Local/JSC	Construction	19.9	90	800
K	Local	Utility	49	35	203
L	Local	Footwear	62	70	2,500
M	Local	Footwear	112.8	160	9,972
N	Central	Shipbuilding	118.9	320	550
O	Central	Shipbuilding	76.8	652.7	2,144
P	Central/JSC	Machinery assembly	9	50	450
Q	Central	Transportation	550	600	434
R	Central	Waterway maintenance	383.3	80	570
S	Central	Construction	1,370	783	4,412
T	Central	Shipping	779	1,375	1,879
U	Central	Port	927	509	5,666
Average (Local)			85.7	138.4	1287.5
Average (Central)			526.7	546.2	2013.1
Average			306.2	342.3	1650.3

* Local / central denotes locally or centrally-managed SOEs, and JSC does equitised SOEs.

Equitised firms were relatively small compared to the sample average both in terms of the size of capital and turnover. The former ranged from VND 9 billion to 35 and the latter ranged from VND 18 billion to 90. The number of workers hired in equitised firms ranged from 203 to 800, which was below the sample average as well. We may interpret that this observation is consistent with Vietnam's policy in which the state keeps big businesses and let go small businesses.

Table 24: Size of interviewed SOEs in terms of capital and employment*

Capital (K): billion VND			Labour (L): person		
Small ($K \leq 20$)	Central	1	Small ($10 < L \leq 200$)	Central	0
	Local	3		Local	2
Medium ($20 < K \leq 100$)	Central	0	Medium ($200 < L \leq 300$)	Central	0
	Local	7		Local	1
Large $K > 100$	Central	7	Large ($L > 300$)	Central	8
	Local	2		Local	10

* The category of small, medium and large is based on the Vietnamese regulation, Decree No. 56/2009/ND-CP on "assistance to the development of small - and medium-sized enterprises" dated 30 June 2009. See Table A2 (p. 237) in Appendix for full criteria.¹⁵⁵

Table 25: Main sources of investment of interviewed SOEs*

Source	Total	Central SOEs	Local SOEs
State budget	5	1	4
Bank loans	12	5	7
Own equity	10	5	5
Employees mobilisation	4	1	3
Investment Development Fund	4	3	1
Others**	3	2	1

* SOEs could choose multiple sources.

** Including domestic investors and FDI.

¹⁵⁵ The title in Vietnamese is *Nghị định số 56/2009/ND-CP về trợ giúp phát triển doanh nghiệp nhỏ và vừa*. In fact, Decree No. 56 defines three categories only – micro, small and medium. However, the General Statistic Office of Vietnam added the category of a 'large' firm.

Table 26: Information of interviewed SOEs

Company	Local / Central*	Ownership Change**	Interviewed	Questionnaire returned	Business area
A	Local	X	√	√	Utility
B	Local/JSC	X	√	√	Construction
C	Local	JSC	√	√	Steel
D	Local	JSC	√		Design and construction
E	Local	X	√		Tobacco
F	Local	JSC	√		Export/Import
G	Local/JSC	X	√	√	Engineering
H	Local	X	√	√	Construction
I	Local/JSC	X	√	√	Construction
J	Local/JSC	X	√	√	Construction
K	Local	X	√	√	Utility
L	Local	X	√	√	Footwear
M	Local	X	√	√	Footwear
N	Central	JSC	√	√	Shipbuilding
O	Central	X	√	√	Shipbuilding
P	Central	JSC	√	√	Machinery assembly
Q	Central	JSC	√	√	Transportation
R	Central	X	√	√	Waterway maintenance
S	Central	X	√	√	Construction
T	Central	JSC	√	√	Shipping
U	Central	JSC	√		Port

*Local / central indicates locally-managed and centrally-managed SOE, JSC means an equitised SOE.

Table 26: Information of interviewed SOEs (continued; unit: billion VND)

Company	Capital	Own equity	Bank loans	Turnover	Average Investment^{****}	No. of workers
A	473	226	n.a. ^{***}	105.4	14	785
B	45	3.5	40	18	300	395
C	70	58	n.a.	0.2	35	70
D	40	3	n.a.	89	n.a.	205
E	91	30	n.a.	453	n.a.	134
F	307	75	n.a.	559	n.a.	856
G	85	4	74	90	4	203
H	5	1.5	0	30	1	315
I	20	3	12	100	n.a.	300
J	19.9	9.9	10	90	n.a.	800
K	49	26	n.a.	35	n.a.	203
L	62	0.6	14.2	70	35	2,500
M	112.8	17.7	62	160	25	9,972
N	118.9	64.2	35.4	320	15	550
O	76.8	6.24	0	652.7	207	2,144
P	9	4.4	18	50	3	450
Q	550	73	n.a.	600	110	434
R	383.3	2.7	370	80	13	570
S	1,370	50.4	725.7	783	n.a.	4,412
T	779	545	218	1,375	350	1,879
U	927	594	n.a.	509	n.a.	5,666
Average (Local)	85.7	35.2		138.4		1287.5
Average (Central)	526.7	167.5		546.2		2013.1
Average	306.2	101.3		342.3		1650.3

^{***} Information was not provided by the interviewed firms.

^{****} Average annual investment from 2000 to the time of the interview (May or October 2005).

6. Budget constraints on state-owned enterprises in Hai Phong

The analysis in this chapter relies mainly on the data collected from the interviews conducted during the fieldwork research. The interviewees from SOEs were mainly personnel at the director or vice-director level. We refer to these personnel as ‘directors’. The analysis of the interviews produces three findings. Firstly, the method of financial support has changed from the direct state budget support to utilise the banks. Secondly, it is not evident whether the budget constraints on SOEs have been hardened. Lastly, not all firms encountered the same softness of budget constraints: the greater the power of the firms, the softer the budget constraints they face.

This dissertation uses the most commonly accepted criteria in the studies on the soft budget constraints syndrome to measure the softness of budget constraints on SOEs (Gainsborough 2005, Kornai 1998, Kornai *et al.* 2003). The three criteria are i) whether the state provides fiscal subsidies from the budget, ii) whether the state exercises leverage to pressure state commercial banks to lend money to SOEs and iii) whether the state applies loose taxation rules to SOEs.

6.1. Fiscal subsidies from the state budget

This is the most direct method of supporting loss-making SOEs. We at first need to clarify that the fiscal support means the state bails loss-making SOEs out by paying the loss on behalf of SOEs. It is disclosed that support from both central and local state budget to loss-making SOEs was suspended *de jure* as well as *de facto* in Hai Phong. According to an interviewed official from the Department of Finance (DOF) of Hai Phong, any support for loss-making SOEs from the state budget ceased formally in 2004. Some SOE directors asserted that the support from the state budget stopped even earlier.

This observation, however, is not compatible with some of the collected answers from the interview. For instance, five SOEs pointed out the state budget as one of main sources of investment (see Table 25, p. 172). Also there is a continuous claim that SOEs have enjoyed significant support from the state budget. How can we explain this contradiction?

The analysis of the interviews reveals that many SOE directors use the term of ‘fiscal support’ to refer to not only bailouts but also public investment expenditures allocated to SOEs. The latter, however, is a legitimate payment made to SOEs ‘contracted’ to provide products and services. As soon as we view fiscal support broadly by including both bailouts and the public investment budget, it becomes complicated whether fiscal support has ceased. SOEs in general carry public investment projects as contractors. Consequently, budget allocations used to be one of main financial sources while it does not necessarily mean bailouts.

Viewing fiscal support broadly make is easier to understand why some criticise that there has been a large support from the state budget while others argue that given a limited state budget support it was impossible for the state to provide SOEs with sufficient capital in order to raise production volumes, strive for higher quality and improve their competitiveness (Beresford 2008, Phan Van Tiem and Nguyen Van Thanh 1996). There have been allocated public investment expenditures and in many cases SOEs have favoured by the state as contractors. In that sense, we cannot deny that SOEs are supported by the state by and large. On the other hand, the amount of fiscal support which mainly was used for fixed capital formation had decreased dramatically decreased. SOEs and some scholar argue that the state has not provided enough support to upgrade the facility of SOEs.

Lack of state budget and forced hard budget constraints

The lack of resources in the state budget led to piecemeal injections of small amounts of capital across the entire state sector in Vietnam. For instance, the state budget was supposed to provide SOEs with thirty per cent of their working capital for implementing the business goals assigned to them in accordance with regulations but most SOEs were given only five to ten per cent of the required capital (Nguyen Ngoc Tuan *et al.* 1996).

The analysis of the interviews reaffirms that SOEs face far less support from the state budget whose amount becomes smaller. SOE directors felt that the state budget support was terminated even earlier than 2004 in which the termination of state budget support was formally declared. This suggests that many Western researchers have a misperception of the formal support enjoyed by the state sector particularly in the 2000s. Majority of interviewed directors of central and local SOEs related that there has been a huge gap between the demand for resources from the state budget and the supply of resources. Interviewed SOEs confirmed that it had been very hard to access the state budget and majority of them had not had any support from the state budget for the last ten years. For instance, a director of one central SOE (Firm S) said that

it has always been hard to access resources, with a low rate of satisfaction. Only three to eight per cent of the demand for capital (has ever been satisfied). Now there is no support from the state budget, and there is no capital expenditure being financed by the state budget.

With reference to the tight state budget, we identified two further remarkable facts. Firstly, there have been systematic delays in reimbursements from the state budget. Secondly, there has been intentional over-servicing¹⁵⁶ by local SOEs (the provision of more services

¹⁵⁶ This is a situation that a company allocated by the state 10 km of work resurfacing the roads, but this company did 12 km of work without any consultation with the state in the expectation of extra payment.

than had been contracted for) and postponed payments from the state budget. A couple of directors of *local* SOEs complained that they had to borrow money from banks and pay interest on the loans to cover the costs of providing assigned works to the local state because the reimbursement from the state budget was delayed for two or even three years. This may explain the case of deferred payment by SOEs to firms which made transactions with SOEs reported in Gainsborough (2005: 11). The strict operation of the state budget expenditure hindered their business activities instead of improving the efficiency in public investment expenditure. Furthermore, other trading partners of SOEs are likely to be negatively affected as well.

With regard to the observation of intentional over-servicing, we found at least a couple of local SOEs that often did more work than was assigned by the plan. The firms complained that the state budget was allocated too slowly and resulted in a lack of working capital. It sounded as though there was inefficiency in the reimbursement procedure but it turned out, from a cross-check with local officials, that a different issue was involved here.

While the state budget is limited, these firms provide extra services ahead of schedule. We have not asked them to do this because the Department (of Finance) is short of budget to allocate, but they just do it. If the firms' extra services are minimal, the Department can pay from the contingent fund. But if they do a significant over-service, we have to pay them next year or the year after. The firms understand this quite well but the planned demand (by the state) is too little for the number of workers they maintain. *Dynamic firms should have explored other jobs. If you fail to get other jobs, one strategy is to provide excess services to the state and hope to be paid in the future* (emphasis added).

Thus, some local SOEs intentionally provided excess services to justify more working days and payments for their workers. The real reason behind this was that the firms were not competent enough to find markets to justify their employment levels.

In fact, many local SOEs mentioned that job creation was one of the most critical business obstacles and some of them submitted bids for projects run in other localities – not in Hai Phong – where they were treated as private companies and it improved the opportunity for them to win projects because there is only a limited opportunity to win the competition among SOEs in the region.

This reflects the fact that some directors of local SOEs have not operated their businesses according to profit-maximising principles but have pursued objectives inherited from the days of state planning. This shows that some directors of local SOEs, twenty years since *doi moi*, still operated in ways inherited from the subsidised period even when they face hardened budget constraints.

Selective state budget allocations as a reward

Some of the SOEs interviewed, nonetheless, claimed that they benefitted from the state budget from time to time. It was said that there were *irregular* supports from the state budget to SOEs before 2004. Yet the amount was not so big. To get the state budget, as it was not allocated automatically, firms had to apply for the budget allocation with proposed plans. A director told that “it was very difficult to get the budget, submission may have no result. However, the submitted plans were neither feasibility studies nor sophisticated investment projects but were broad draft plans”.

The confusion is that working capital has to be provided to the firm before the production process, while the payment for services should count as revenue and not as working capital. The SOEs were indeed getting paid for their services but not necessarily in

advance and not regularly. With regard to the irregular allocation, the answer from officials suggests the state budget faced a chronic shortage of funds. One of the officials from the DOF described the situation as follows:

Too many firms were short of capital. So the most stricken units would be given a budget allocation first. Then the following year, other firms would be given priority. There are many firms to be paid and funds are insufficient. For example, if the local budget could only afford one billion Vietnamese dong (equivalent to fifty-five thousand US dollars) per year, then each firm would have several million Vietnamese dong (equivalent to few hundred US dollars) which would not help any firm. That is why we cannot give every firm an equal share but have to concentrate on certain firms and move to others in later years.

The selection by the state has been done according to the annual turnover or profits of the firms. The higher profits and sales the firms recorded, the higher the possibility of winning the budget support the firms had. It was likely to be a self-reinforcing process.

This pattern is not limited in Hai Phong. Gainsborough (2005: 9) argues that “profitability was the key criteria in determining whether companies were able to access capital” in four provinces including Hai Phong. For example, a large SOE in Can Tho “stressed the importance of profitability, saying that access capital had ‘become easier’ but only for companies that do business profitability” (*ibid.*).

Contrary to general perception that financial support from the state budget is to help loss making firms, the support from the state budget in Hai Phong was to increase the size of working capital. The allocation from the state budget was to compliment SOEs on their good performance. An official interviewed told that “the state does not supply (capital) to the losers”. So the state as an investor uses budget support as a reward for well managed operation of firms to ‘keeping the big and releasing the small’ (Cheshier *et al.* 2006: 5-6).

Four (out of thirteen) local SOEs interviewed that their firms were allotted capital from the local state budget *irregularly* and the *local* state budget was one of their main sources of investment (see Table 25, p. 172). However, by cross-checking with the DOF of Hai Phong, we discovered that there was probably some confusion about what constituted capital. The officials of the DOF defined and explained the terms as follows:

In the subsidy period, the state provided SOEs with two types of capital: fixed capital and working capital. Fixed capital was used for assets such as machines and office buildings, factories and workshops whereas working capital was used for input materials. The state calculated the amount of working capital allocated to an SOE by using a norm – dividing a firm's annual turnover by the number of production cycle(s) over the year.

Nowadays, there is no longer distinction between fixed and working capital. They are commonly called 'business capital'. SOEs can either sell fixed asset which was not allowed in the past to convert into business capital or buy fixed asset from their revenues. Firms no longer need to depend on the state.

Now, there is no more support of working capital to SOEs from the state budget. If an SOE director spoke (to you) that there was support from the state budget it must be the supplement of working capital which was done during the 1990s following a regulation to increase the size of working capital by maximum thirty per cent of charter capital.

According to the officials interviewed the state budget no longer provides SOEs with working capital. It seems SOE directors were confusing general state investment expenditure with financial support from the state budget because the explanation of the officials was proved to be correct in another interview. The director of a public service company (Firm K) said that

our company received capital from the local state budget for the operation of the company, irregularly. The higher level department (the controlling organ) informs us about the availability of the state budget and then we ask for the allocation.

Although the director used the term ‘capital for the operation of the company’, the capital provided to this company was the allocated budget expenditure for the purchase of the service, in this case maintaining telegraph poles and the traffic light system of Hai Phong.

Summary

Officials and SOE directors unanimously spoke that there is no more fiscal subsidies to loss-making SOEs to bail them out. If we include the budget allocation for public investment expenditures then the situation turns into a complexity. Some of SOEs, most of them are local SOEs, have been supported from the state budget in the form of payment for their products and services. In the sense that a proportion of turnover of an SOE occurs from transactions with the state, it can be considered that an SOE faces soft budget constraints. However, this conclusion should be made with caution. As clarified from the interview, the allocated amount is equivalent to few hundred US dollars on average in a year and furthermore, due to the lack of state budget, these allocations have been done in rotation. It is not straightforward whether this forced hard budget constraints have worked positively or negatively to SOEs’ performance.

6.2. Application of taxation rules

Our aim is not to examine the overall efficacy of the tax authority in Vietnam but to investigate the possibility of soft budget constraints operating for SOEs through exemptions, reductions or deferred payments of tax as methods of getting indirect financial support. SOE directors interviewed confirmed that their firms have not received any preferential treatment from the tax authority. We found no counter-evidence through

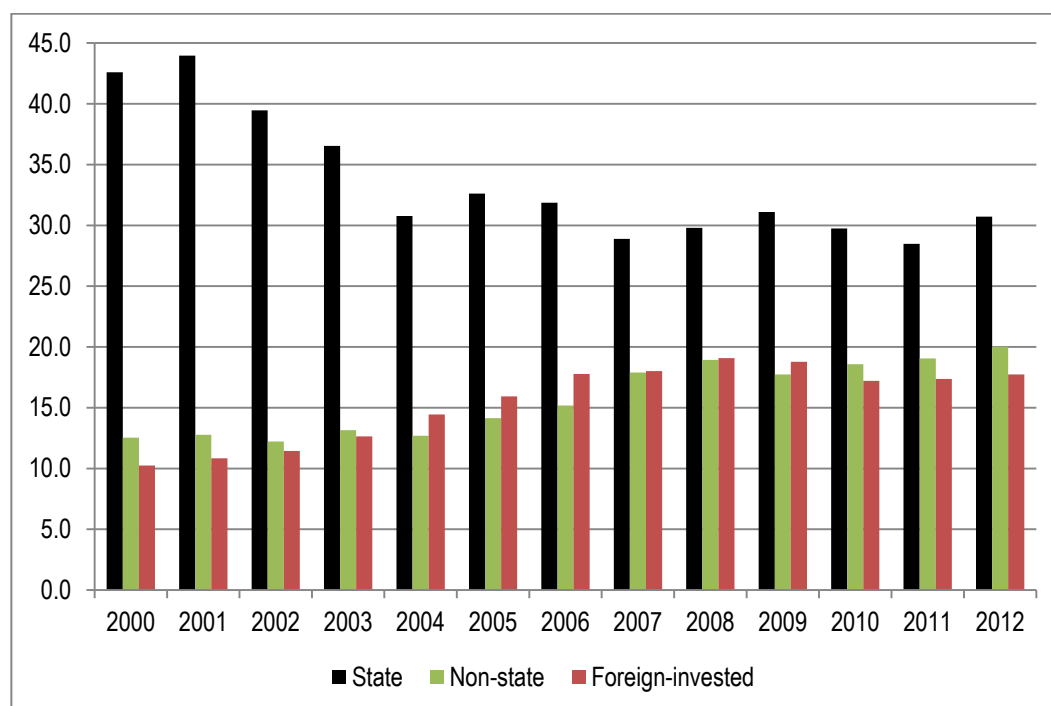
cross-checking with the officials of the DOF which is an organ in charge of taxation. Tax rules appeared to be applied according to the relevant rules in Hai Phong.¹⁵⁷

In general, the loose application of tax rules by a tax authority provides tax exemptions without clear reasons and can allow delays in the payments of tax. No SOE directors in our sample provided any evidence that their firms may have received any exemptions by the tax authority. In fact, every single director stated that the first thing their firms had to do with their revenues was to contribute to the state budget by paying corporate income tax at a rate of twenty-five per cent.

Their answers are convincing because the tax contribution of SOEs account for a large share of the budget revenue and the state emphasises SOEs function of contributing to the state budget (Fforde 2007). As can be seen from Figure 20 (p. 184), the state sector is the major (if gradually declining) source of revenue for the state budget. The contribution from the state sector to the domestic state budget was 36.5 per cent (equivalent to USD 1.8 billion) and 30.8 per cent (equivalent to USD 2 billion) in 2003 and 2004 respectively while the figures for the non-state sector were 13.1 per cent and 12.6 per cent in the same years.

¹⁵⁷ This however does not necessarily mean that the application of taxation rule is transparent. It is reportedly said that tax officers negotiate the amount of tax with businesses in order to obtain personal earnings which is again not necessarily purely 'personal' earnings.

Figure 20: Structure of the state budget revenue by source (%)



Source: General Statistics Office of Vietnam, *Statistical Yearbook (2005 – 2013)*. Hanoi: Statistics Publishing House.

With regard to tax exemptions and reductions, newly equitised firms received the benefit of a two-year tax holiday according to the rules that were introduced to encourage SOEs to change their ownership from state-owned to joint-stock. This finding is different from what Gainsborough (2005) finds. It is reported that some SOEs and equitised SOEs from Hai Phong admitted to receiving tax breaks. However, what interview team found was that SOEs operating in strategic areas are granted tax reduction by the regulation. It seems that we should carefully interpret the finding of Gainsborough in terms of ‘soft’ budget constraints on SOEs.

Some of interviewed SOEs had affiliated companies in the form of ‘mother and children’ companies. We wanted to know if the mother companies paid taxes on behalf of their affiliated firms, to ascertain if the mother companies provided any financial support to their subsidiary companies in order to bail them out. The reply was “no, tax is the

responsibility of the affiliated firms”. However, when the mother companies were asked whether they would support their affiliated firms when the affiliated companies have difficulties in the future, the response was “yes, not because of paternalism but because our money has been invested in those subsidiary companies. We do not want to lose our invested money”.

To summarise, neither central nor local SOEs operating in Hai Phong were treated in a favoured way with regard to tax payments. This equality of treatment also applied to equitised firms. They did not feel any change in the treatment by the tax authority from when they were under the ownership of the state to when they changed into JSCs.

6.3. Accessibility to bank loans

Using direct support from the state budget is a politically costly way of supporting SOEs because these transfers are more apparent to the wider public. In contrast, the banking system, in particular state commercial banks, can be used to provide support to SOEs without the same political cost because these transfers are not as transparent. This is one reason why centrally planned economies in Eastern Europe used the banking system frequently to support SOEs, and since a failure to repay loans did not lead to bankruptcy proceedings, this method of financing amounted to soft budget constraints on SOEs (Kornai *et al.* 2003).

We observed a similar pattern of financing in Hai Phong. While direct fiscal support from the state budget or a loose application of tax rules was not observed, the use of the banking system to mobilise capital on relatively easy terms for SOEs was widespread.

This section examines whether SOEs have easy access to bank loans and more importantly how connections – which are important for all business operations in

Vietnam – influenced access to loans. If the accessibility of loans is different from company to company, this is *prima facie* evidence that factors like differences in networks and connections could be playing an important role in determining accessibility of the firm to bank loan. But before we proceeding, it might be helpful how state-owned commercial banks (SOCBs) are related to SOEs.

Having easy access to credit does not necessarily carry value judgement because relationship-based lending can be established, resulting in improvement of credit availability to businesses particularly when there are small and medium-sized (see Allen *et al.* (2005) for the Chinese case, and Hansen *et al.* (2004) and Le *et al.* (2006) for the Vietnamese cases). Also this relationship-based lending is not unique to developing economies (Malesky and Taussig 2009). Banks in developed countries use soft information to ameliorate asymmetric information problems through careful screening of borrowers (Gerschenkron 1962) and firms with longer banking relationships receive better terms in the form of lower interest rates and less collateral requirement (Diamond 1991). Nonetheless, we need to be careful to extend the relationship-based lending in developed economies into developing economies because the context may not be the same. The relationship-based lending in developed economies has worked in a way of enhancing the screening of risky projects while in developing economies the relationships are often defined as bonds that originate outside of banking relationship which are commonly referred to “connections” (Malesky and Taussig 2009: 537).

There are five state-owned commercial banks (SOCBs) in Vietnam of which two are solely owned by the state (Agribank and the Bank for Investment and Development of Vietnam) and three banks with state ownership between 80 to 92 per cent (Mekong Housing Bank, Vietcombank and Vietinbank). The share of SOCBs in credit allocation and deposits was between 70 and 80 per cent in 2000, which declined to 45 to 50 per cent

in 2010 because of the increasing number of joint-stock banks (JSBs) (World Bank 2012: 28).

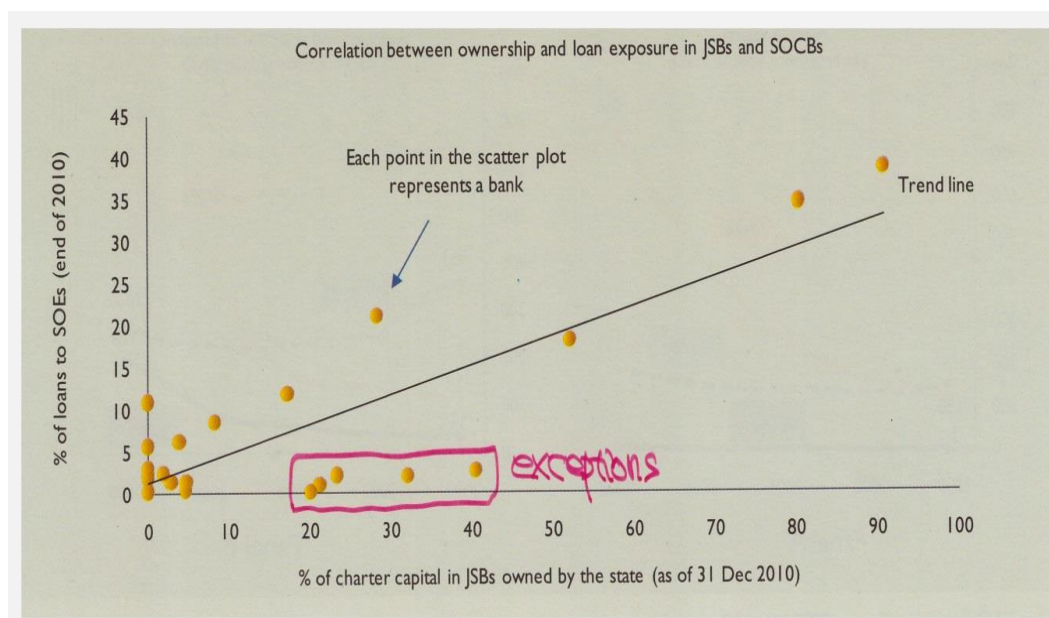
The ownership structure of banks in Vietnam indicates that the state sector – the state, SOEs and SOCBs – exercise considerable ownership. By the end of 2010, the state has direct ownership in nine banks – five SOCBs and four JSBs – out of 29 banks. SOCBs have some ownership in six JSBs. The majority of state ownership in the banking sector comes through SOEs which hold charter capital in 19 JSBs (World Bank 2012: 29).

While the presence of the state sector in the banking sector is large in terms of number of banks, but the state ownership in JSBs has progressively increased. Between 2005 and 2010, the number of JSBs in which the state has ownership increased from 5 to 22. Nonetheless the size of state capital is small and declines. The share of charter capital held by the state in the entire banking sector rapidly declined from 87 per cent to 34 per cent between 2005 and 2010. The share of the state capital becomes much smaller in JSBs. It was 19 per cent in 2005 and fell to 10 per cent in 2010 (World Bank 2012: 29-30).

Why do SOEs have ownership in many banks while the size of ownership is rather small? The pattern of the state sector ownership in the banking sector is different from the industrial sector in which the state capital shows a high concentration ratio. In the banking sector the state sector ownership spreads out to many JSBs with a little amount of ownership capital. Why is that? It is because SOEs can use JSBs as a channel of capital mobilisation. World Bank (2012: 31) argues that there is a positive correlation between the ownership structure of the banks and their loan exposure to SOEs. Hence it is not always necessary “require a controlling stake in JSBs to influence lending activities in favor of” SOEs, although there are some exceptional cases (see Figure 21, p. 188). But it

should be noted that the state requires “SOEs and SOCBs to subscribe to the charter capital of JSBs to make the equitisation process successful” (World Bank 2012: 29).

Figure 21: Correlation between ownership and loan exposure in JSBs and SOCBs



Adopted from World Bank (2012: 31, Figure 2.8).

Let us return to the case of Hai Phong. We examine the softness of budget constraints by asking three sorts of questions to investigate the types of networks and business connections that determine the probability of getting a soft loan, following the analysis of Kornai *et al.* (2003) and Gainsborough (2005). The questions we used to structure our investigation were i) the duration of the bank loan, ii) the type of enterprise – distinguishing between centrally and locally managed SOEs and iii) the type of ownership – SOEs versus equitised JSCs.

Both central and local SOEs in Hai Phong were largely dependent upon bank loans for mobilising capital. Most of the firms in our sample replied that bank loans were one of their main investment sources and financed a large proportion of the companies' liabilities (see Table 25, p. 172). SOEs borrowed money not only from SOCBs but also

from private banks. SOE directors agreed that they had personal relationships with banks, mostly with SOCBs, and the quality of these relationships were an important factor that was likely to have an influence on the successful consideration of loan applications.

Long term versus short term loans

It is disclosed that there were important differences between applications for long-term and short-term loans. Banks require firms to submit feasibility studies or project documents when long-term loans were applied for, whereas they request relatively simple paper work such as business contracts or annual business plans for short-term loan applications. Here are some director responses.

For investment capital (long-term loans), (we) prepare project documents for the loan applications with calculations of the repayment period for each specific project. Banks review and appraise the feasibility and approve the applications. Upon disbursement, financial documents must be kept in banks. For short-term loans, banks negotiate the terms of the loans and the amount of annual loans based on business contracts, construction contracts and projected outputs. The short term loans are secured by collateral. In the past, banks determined the amount of loans based on construction contracts or business contracts based on *trust* (quote from an equitised local SOE, Firm G; emphasis added);

A long-term loan requires technical and economic reports or investment project documents. Short-term loans only require business plans. Now we must also have collateral secured at the bank (quote from a local SOE, Firm I);

The loan application is dealt with by (our) General Corporation. A large scale investment needs loans arranged and prepared by the General Corporation. However, our company has to sign the credit agreement

directly with banks and is responsible for paying the principal and interest. There is no difference in the application process between long-term and short-term loans. However, the portion of loans which require collateral has increased in the last five years (quote from a central SOE, Firm Q);

As the quotations above indicate, central and local SOEs provided mostly similar answers about the differences in the application process for long-term and short-term loans. No discrimination based on the ownership type was detected in bank loan applications.

Formal and informal rules in bank loans

It was discovered that all firms are formally required to put up collateral or mortgage their assets when they applied for loans regardless of the term of borrowing. The interviewed directors pointed out that this was one of the biggest changes in the business environment over the last five years as of 2005. Putting up collateral was required from all SOEs when they applied for bank loans after Decree No. 178/1999/ND-CP on ‘credit institutions loan security’ promulgated on 29 December 1999 as the Decree introduced a condition that “The provisions at Point 1, Section II of Resolution No. 49/CP of May 6, 1997 of the Government on the State enterprises borrowing capital from the State commercial banks *without mortgage* and other previous stipulations on mortgage, pledge and security for bank loans cease to be effective” (emphasis added) in Article 38.¹⁵⁸

Tenev *et al.* (2003; see FIGURE 3.6 and FIGURE 3.7 on page 63) provide a nice reference to loans without putting up collateral. They find that 29 per cent of loans are made without putting up collateral among SOCBs while 53 per cent of loans are made without putting up collateral among JSBs. Also 65 per cent of private firms answer that

¹⁵⁸ The title in Vietnamese is *Nghị định số 178/1999/ND-CP về bảo đảm tiền vay của các tổ chức tín dụng*. This was amended with supplemented articles by Government Decree No. 85/2002/ND-CP in 2002 which did not contain any significant changes from Decree No. 178.

putting up collateral as a main difficulty in getting bank loans while 12 per cent of SOEs pick this out as a main difficulty.¹⁵⁹ Hence, we can conjecture that lending without putting-up collateral is found not only in SOCBs but also in JSBs.

We, however, also found that the application of Decree No. 178 was not firmly established and banks applied the rules differently from firm to firm. For example, some SOEs were able to take out loans from banks on the basis of their credibility, reputation or trust. Gainsborough (2005: 10) calls this ‘unsecured’ lending referring to “borrowing on the basis of one’s reputation (*tin chap*) or by showing a business contract”. Like as in other provinces, the interviewed directors in Hai Phong used the term ‘*tin chap*’ – which roughly translates as creditworthiness in general – to describe the effects of reputation. The term can be used when there is a kind of long-term relationship between two parties, which enables them to ask for something, including a loan, without the requirement of a tight formal process. It does not mean a verbal promise between two parties. The long-term relationship refers to an established connection between two parties, which is extendable to third parties to establish new connections.

In general, reputation is the result of repeated transactions. If a firm does engage in borrowing and re-paying properly over a long time, the firm builds a virtual relationship, often called prestige (*uy tin*), with banks and is able to take out loans on the basis of reputation without putting up collateral. Reputation can also be based on evidence of other connections that establish that a firm is well-connected. For instance, a firm that has been successful in getting access to land, in a context where land use is politically determined, can easily establish its reputation.

¹⁵⁹ The greatest obstacle for SOEs in getting bank loans is a high interest rate (Tenev *et al.* 2003: 65; FIGURE 3.8).

When we included a discussion of reputation it turned out that banks were very flexible in the application of Decree No. 178. For example, a local SOE director told us

In regard to putting up collateral for bank loans, what we as an SOE have to do is to show our 'red book' to the bank in order to confirm our land use rights.¹⁶⁰ That's all. We do not have to give any collateral like ordinary citizens. What happens is that the bank will send a team to investigate and check our red book (quote from a local SOE, Firm C).

In some cases, reputation was used to set the upper limit on loans that could be granted without collateral. Only if a firm took out a larger loan than the limit would it have to put up collateral.

In a nutshell, there is equal treatment for all firms regardless of ownership type of theirs in Vietnam and therefore there is no favouritism when firms apply for bank loans. But as our company has been working with the bank for many years, we have a good reputation, prestige and a good relationship with the bank, so our requirement for collateral is smaller. It is the result of trust between the bank and the company. Now the bank gives us fifty per cent of loans on the basis of credibility and the rest is based on the collateral (quote from a central SOE, Firm N).

It was in this sense that local SOEs and central SOEs experienced a *difference* in the confidence and reputation they could develop with banks. Many directors from local SOEs said that the value of their assets was not large enough to get bank loans. In principle, local SOEs were unable to borrow more than a certain amount of money without mortgaging assets. The actual value of the assets owned by local state companies was limited and this limited the loans they could take out. Therefore, according to the directors, they had to seek loans based on a 'virtual relationship'. Several local SOEs felt

¹⁶⁰ The booklet of the land use rights is widely called as the 'red book' in Vietnam because the colour of the booklet is red.

insecure because banks could require them to put up collateral at any time or could lower the proportion of loans based on reputation.

On the contrary, most directors of central SOEs were *confident* that they had good relations with banks. They thought they deserved the loans based on reputation because the value of their assets was high enough to make banks trust them and lend to them without putting up collateral.

From the viewpoint of banks, the reputation and assets of a potential borrower are important considerations for banks. In advanced countries the asset base of a firm contributes to the security of the lender but in the Vietnamese case, the asset base appears to contribute to trust without being directly tied down as collateral. The link between the asset base and trust is therefore an interesting question and politics is at least one important intermediate variable in this relationship. One of our respondents puts this quite clearly:

Local SOEs are under provincial departments. Maybe the departments at a provincial level are not capable of winning the trust of banks. We are a central state firm under the Ministry, and the Ministry is trusted by the banks. The assets of the General Corporation are also large and spread out from the South to the North (quote from a central SOE, Firm Q).

It is not difficult to infer from the quotation above that the level of a state organ that governs an SOE, whether local or central, is one of the factors influencing the reputation and consequently the negotiation power of the SOE. The answers provided by central SOEs when they were asked about the application process for long-term and short-term loans were consistent with this analysis. Responses from the directors of central SOEs indicate that General Corporations, often called mother companies, were deeply involved

in dealing with bank loans for the children firms of theirs. As discussed earlier, General Corporations are founded based on Prime Ministerial decisions and their location in the administrative hierarchy is equivalent to that of ministries. This implies that General Corporations have considerable political power. It is therefore not surprising that the interview reveals that the central SOEs had better connections with banks than local SOEs and equitised JSCs did.

The direct and indirect support from the governing organs of SOEs explains why banks prefer SOEs for their lending business. Both tangible and intangible backing makes banks feel that loans to SOEs and particularly to well-connected large SOEs will not turn into non-performing loans. Although SOE directors claimed that banks granted them loans because they built reputation, banks as business entities lend money to SOEs because there is a guarantor of last resort operating behind SOEs. This argument is supported by a local SOE director (Firm I) who said that

it is easier for banks to grant loans to SOEs than to (private) limited liability companies because banks have more confidence in SOEs than in other entities (emphasis added).

Nonetheless, it does not necessarily follow that banks manage loans to SOEs with substantial discretion with the confidence that however delinquent the firm, its connections with politics will effectively secure the loans. On the contrary, we do not find that banks are excessively flexible about dates of repayment or that they approve additional loans when a *trusted* firm has outstanding overdue loans. Only one central SOE (Firm S) director answered that it had been given a flexible repayment date and had been able to get another loan without paying off all outstanding loans. Many of the interviewed firms replied that it would be fine not to keep the due date once, but if they repeat then the bank would not provide loans with them any longer. Therefore, they need

to stick to the due date. The political power and backing that SOEs enjoy might help to some extent to get access to loans, but it works only if the SOE does not damage its reputation by breaking the agreed repayment schedule of loans. The informal rules therefore are important in one sense but they do not mean that gross violations of borrowing norms are tolerated.

Equitised firms versus SOEs

How did equitised firms perceive their access to bank loans before and after equitisation?

All directors of equitised firms answered that there had been no significant change in terms of their access to bank loans. They had to put up collateral or mortgage assets – this change had started before they transformed the ownership type – and few of them still enjoyed the benefits of reputation (Firm C and J). The ownership change had not influenced the established relations between equitised firms and banks.

Nevertheless, the ownership change could create difficulties for firms in mobilising capital due to related government regulations. A director of an equitised firm (Firm A) complained that

(after changing the ownership type) the upper limit of loans decreased because it was now based on the size of legal capital of the company, so the company suffered. Now bank loans are insufficient for the mobilisation of capital and the firm has to invest its own resources together with the bank in case of projects which require long term investments.

Can putting up collateral harden budget constraints?

The interviewed SOE directors stated that putting up collateral is one of the most significant changes in business environment for the last few years, which made them feel the access to bank loans more difficult. Has this change really hardened the budget

constraints on SOEs? We may answer the question by addressing the issue that to whom SOE directors think the assets which were put up as collateral belong. An SOE director may do not care when banks foreclose on the mortgaged assets in the case of non-payment of loans if s/he considers the mortgaged assets belong to the state. If, however, the SOE director regards the assets put up as collateral as what belong to the firm, s/he would try her/his best to ensure that banks did not foreclose on the assets mortgaged.

Why is it assumed that the SOE director tries her/his best to keep the mortgaged asset which belongs to the *firm* not to her/him? Before proceeding, let us take a look at Table 25 (p. 172) again. Listed sources of investment are bank loans, own equity¹⁶¹, state budget, employees mobilisation and investment development fund. All of them except bank loans belong to the assets of an SOE or the state. *But actually whose?* This, however, is not a simple question in the Vietnamese context because there is no clear distinction among own equity, employees mobilisation and Investment Development Fund.

Own equity

Firstly let us consider ‘own equity’. The owner of SOEs is the state and own equity is supposed to belong to the state. The analysis of the interview reveals that this is not always the case in Vietnam. Many of interviewed directors agreed that the assets of SOEs belonged to the state. Nevertheless, they also insisted that *the SOEs had the right to the assets* at the same time because the SOEs were allowed to manage and use the assets for firms’ own purpose. One director even said that the assets were not the state any longer because the assets were already assigned to the company. The right to ownership is blurred.

¹⁶¹ It is ‘*von tu co*’ in Vietnamese which is translated into various terms in English such as ‘own capita’, ‘own equity’ and ‘owner’s equity’. The standard terminology used in accounting is own equity.

While the implication which own equity delivers has changed over time, the blurred ownership to own equity goes back to the 1980s. Own equity was understood to mean capital that SOEs themselves had accumulated (Fforde 2004, 2007) and which “therefore should be seen as theirs. Much of this seems to have been lost, however, in the crisis years of 1989–1990 or was then appropriated by higher levels in the early 1990s” (Fforde 2007: 48) through the changes in depreciate fund and the imposition of capital tax, which caused significant resistance of SOEs because they “were arguing that that capital tax could not be applied to their ‘own capital’” (*ibid.*: 207). The right to tax own equity conflicted with the right to ownership of it.¹⁶² Similarly Gainsborough (2005: 6) argues that “how ‘own equity’ is defined and understood among SOEs is more complex given the more ambiguous property rights regime”.

Nowadays own equity is understood to be ‘self-generated capital’ – two firms used this term, which was generally understood to mean ‘the additional capital of the firm derived from retained profits’.¹⁶³ Many firms understood own equity as a fund which firms could use for re-investment or the fund remaining after paying tax. For example, according to an interviewee from a local SOE (Firm H),

Profits are used first to meet tax obligations. Then there is a contribution to the reward fund and the welfare fund. For re-investment we have the investment development fund, and *this constitutes own equity*. ... Providing public services which is our main product sometimes yields profits and investment development fund is accumulated from the profits. We consider this fund to be our own equity (emphasis added).

¹⁶² See Chapter 8 of Fforde (2007) for in-depth description of the significance of own equity in the commercialisation of SOEs in the 1980s.

¹⁶³ See Table A4 (page 239) in Appendix for the listed answers on own equity from SOE directors.

Other firms defined own equity differently like as “the accumulated the annual profits to be used for the procurement of equipment and machines” (Firm I); “money accumulated from profits after tax” (Firm R); “a fund created by the firm from the profits of production and business every year” (Firm Q); “the fund mobilised by the firm from various resources not the fund supplied from the state” (Firm B).

Although various answers were returned to the question that what is meant by own equity, it can be summarised that profits minus tax payments minus required fund accumulation such as welfare fund, financial reserve fund and investment development fund. Mobilised or self-generate by ‘the firm’ was the word used by SOE directors to indicate that own equity is something belongs to the firm *not* to the state. Own equity was itself ambiguous and referred to various sources of funds and expenditure patterns within SOEs in the context of unclear property rights.

In our sample of firms, the amount of own equity ranged from VND 1.35 billion (equivalent to USD 86,538) to VND 545 billion (equivalent to USD 34 million) and ranged from 0.7 per cent to 70 per cent of the total capital of the firm. The size of own equity had no correlation with types of ownership and whether the firm is locally or centrally run.

Not surprisingly there was confusion of terms among interviewed directors. The most notable case was that they mixed own equity up with ‘investment development fund’ (*Quy Dau tu Phat trien*) which some SOEs pointed out as one of main sources of investment (see Table 25, p. 172). Why did such confusion occur? It might be due to government regulations.

The Vietnamese government allows SOEs to use profits after tax for augmenting their capital, building up financial reserves and improving the material conditions of their

workers. According to Circular No. 64/1999/TT-BTC on ‘Guiding the distribution of after-tax profits and management of funds in SOEs’¹⁶⁴, every SOE and equitised SOE can accumulate funds using up to a certain proportion of their profits: a financial reserve fund (ten per cent of profits)¹⁶⁵, an investment development fund (fifty per cent of profits)¹⁶⁶, a severance allowance reserve fund (five per cent), a reward and welfare fund (subject to additional rules)¹⁶⁷. If there were *any available profits* after deducting all the funds stipulated in Circular No. 64, these profits would fall into the category of the investment development fund. This regulation coincides with what SOEs directors defined ‘own

¹⁶⁴ This was promulgated on 7 July 1999 and whose title in Vietnamese is *Thông tư số 64/1999/TT-BTC về chế độ phân phối lợi nhuận sau thuế và quản lý các quỹ trong doanh nghiệp Nhà nước*.

¹⁶⁵ As for the financial reserve fund, our interviewees had a more ambiguous and broader perception of the purpose of this fund. The fund was designated to make up for asset losses or damages incurred by the firm during the course of its business. In reality, the understanding of directors ranged across a wide range of possibilities. For example, the financial reserve fund is kept as a “contingency fund for financial risks”; to “cover the risks of business operations”; to prepare “contingencies due to unexpected losses or damage from force majeure”; or more broadly, to “support production and business and cover against risks”. Some unusual answers included the response that the fund was “retained to cover the reassignment of jobs”; for “contingency payments to cover bad debts”; and “to provide subsidies to jobless employees”. The ambiguity in regard to the perception of the appropriate uses of the financial reserve fund suggests that the firms spent the fund for a wide variety of uses and possibly beyond the legally appropriate ones.

¹⁶⁶ The purpose of the investment development fund was to “supplement the capital of SOEs (*bổ sung vào vốn kinh doanh của Nhà nước*)” by investing in business expansion, renovation of technologies and equipment; contributing capital to joint ventures and purchasing shares or contributing stocks. Interviewees commonly used the term “re-investment” to refer to the purpose of the investment development fund and they accumulated the fund at the proportion of fifty per cent of profits after tax in general.

¹⁶⁷ The interview team asked questions referring to Circular No. 64 to see if SOEs had a clear understanding of the accumulation and usage of each fund. The answers of directors about the purpose of each fund and its amount revealed that the understanding about the purpose of some funds was relatively clear. Directors had a clear understanding about the usage of the reward fund and the welfare fund as stipulated in Circular No. 64 – to reward the innovative activity of workers and to secure the welfare of the workers. The amounts accumulated under the two funds varied from firm to firm as we would expect. Nevertheless, four local SOEs and two central SOEs deducted an unexpectedly high proportion of after-tax profits (between twenty to forty per cent) or VND 13 billion (equivalent to USD 833 thousand).

equity' – profits minus tax payments minus requested funds. Consequently, a proportion of investment development fund would be own equity.

While the regulation does not define any *own equity belongs to the SOE* many interviewees believed that the firms had right to own. If we include investment development fund as a part of own equity, SOEs reliance upon own equity in investment expenditure is heavier than that upon bank loans. A similar result is found in the analysis of Gainsborough (2005: 8) and he uses this result to argue that the “heavy reliance on ‘own capital’ for all firms regardless of ownership type ... suggests that ... companies are not especially ‘flush’ with budget or bank capital”.

Capital mobilised by employees

As we examined after *doi moi*, own equity came to mean accumulated (or retained) profits that were the result of the business activities of the firm separate from any capital injected by the state into the firm. The post *doi moi* period was one where there state did not have enough capital to inject into SOEs, leading the then Governor of the State Bank of Vietnam to say that “(the state) must find capital for the (economic) units. But if those units are to survive, *they* must provide at least half of their own equity” (emphasis added; *Saigon Giai Phong*, 21 May 1991; Translated in JPRS-SEA-91-019, 12 August 1991). Here is another ingredient of blurred property rights: ‘capital mobilised by employees’.

Three local SOEs said that funds mobilised from their own employees was one of their main sources of investment funds but only one central SOE counted it as a source of funds for investment (see Table 25, p. 172). One local SOE (Firm I) said that twenty-five per cent of its working capital came from employees’ contributions.

In general, companies mobilised capital from their employees and rewarded their contribution by paying interest at a higher rate than the average bank interest rate. These

mobilisations from employees were usually resorted to in emergencies when a firm encountered financial troubles or was unable to repay bank loans on the due date. The mobilised funds could be considered as short term loans from employees to protect the company's reputation. In addition, these types of mobilised funds could be used for risky projects because it was hard to mobilise fund from banks or the state for such projects.

Other regulations made the concept of own equity even more obscure. According to articles of Decree No. 50-HDBT¹⁶⁸, promulgated on 22 March 1988,

Article 4. Assets of enterprises belong to the entire people and are entrusted by the state to collectivised workers headed by enterprise directors for direct managerial control and use in developing production and business. Enterprises are responsible for maintaining and constantly supplementing and renovating their assets depending on the production requirements by using their *self-procured funds, credits and other funds mobilised from various sources* (emphasis added; SWB, FE/0133/C/1-8, 22 Mar 1988).

It can be inferred from Decree No. 50-HDBT, together with the message of the Governor of the State Bank of Vietnam, that there was no clear differentiation between state capital and a firm's capital and the ownership of the capital that was raised or of the profits that were earned as a result was not clear.

This confusion reflects ambiguities in the law about the ownership of assets in SOEs. For example, of the total capital of a state enterprise, there is a portion contributed by employees, a portion injected by the state a long time ago at the early stages of the transition, a portion accumulated from profits and a portion contributed by firms as they were requested by the State bank of Vietnam, but it is not clear what the rights of the

¹⁶⁸ It was titled "Regulations for state industrial enterprises" (*Nghị định số 50-HĐBT, về Điều lệ xí nghiệp công nghiệp quốc doanh*).

different contributors are. The confusion over own equity is one reason why equitisation has proceeded so slowly. One of the important preconditions of equitisation is to know the value of the firm's assets. Unless the ownership of assets or the claims of different parties can be clearly identified, it is technically impossible to assess the value of the equity.

Is putting up collateral likely to be effective?

The revealed perception of directors is that the assets belong partly or wholly to the firm, and this explains why the requirement of collateral has had a binding effect on firm behaviour. This is different from the behaviour of firms in socialist countries that Kornai described. Firms and their directors stand to lose something real if they fail to pay their loans back. Furthermore, according to a central SOE director (Firm K), foreclosures do occasionally happen. He told a story where a bank auctioned mortgaged one SOE properties to recover some of its outstanding lending.

There, however, was a different observation on the bank's capacity of collecting outstanding debts. Gainsborough (2005: 11) cites companies' comments such as "banks never manage to recover all of their capital in the event of a *default*" or "banks have to bear the losses if firms are unable to make payments because of *corruption*" (emphasis added). His interpretation is "banks could expect little help from the political authorities" (*ibid.*). We may need to draw attention on word 'corruption' or 'default' from which politicians are likely to reluctant to intervene to help relevant firms because of political burden. In the case of corruption, they would like to hide themselves and in the case of default, we can conjecture that those firms had not had to be in default if they had 'decent' political connections.

In fact, the properties that they are requested to provide to banks belong to the state in principle as the firms are ultimately state-owned. The assets of SOEs are perceived by

directors as belonging both to the state and to the companies. This helps to explain why the requirement of collateral introduced by Decree No. 178 has worked as an effective constraint on SOEs in Hai Phong.

6.4. Perception of SOE directors versus budget constraints

As Kornai *et al.* (2003) argued, the hardest obstacle to removing soft budget constraints is the stubbornness of SOE directors who expect bail-outs. Gainsborough (2005: 5-6) assesses the changes in firm expectations by asking two respects: whether the access to state budget capital and to bank capital changes for the last 3-5 years. He finds that firms felt the access to state budget capital got harder and the access to bank capital got easier.

As we examined our interview shows a similar result in terms of the access to state budget capital. Nonetheless, there was not clear evidence that the access to bank capital got easier for the last three to five years in our interviews. Rather, SOE directors responded that putting up collateral made them feel budget constraints got harder because SOEs were able to get bank loans without putting up collateral before Decree No. 178 was promulgated. However, ease of access does not necessarily tells the hardness of budget constraints because easy access can be a result being exposed to the banking system (Gainsborough *ibid.*).

Table 27: How do SOE directors consider of bailouts by the state?

Company	Comments
A, B, C, D, E, H, I, J, N, P, Q, S and U	No support.
F	No support. But must consider why SOEs make a loss and if it is not the fault of director, the state can support.
G	Yes. Many schemes under construction are funded by the state budget. The reimbursement is very slow. Therefore the company has to get the loan and pay the bank interest. As a result, the schemes bring about low effectiveness and no profit. In that case the state budget must be mobilised to cover up the loss for the firm.
K	The Director is responsible for the loss. If the loss is caused by a policy change, the gov't is responsible for it. The state budget should cover the loss for utilities which implement the assignment by the government.
L	Loss must be analysed to find reasons. The state budget cannot be mobilised to cover up the loss of the enterprise. When the loss is up to a certain limit, production could not be continued, the bankruptcy procedures must be applied according to laws.
M	The loss of the previous year must be filled up by profits of the following year. If the enterprise suffers loss for 2 consecutive years, the director must be dismissed according to legal regulation.
O	If it is the result of natural calamity it should be mobilised, if it is the fault of the subject it should not be mobilised.
R	Responsible for the loss: the Director; handling the loss: the gov't. Firms working in the public services may make a loss due to objective reasons. The state should fill up the loss. Other firms not working for public do not need.
T	The Board of Directors are responsible for the loss; the whole firm needs to refund the loss after a course of years.

To assess the perception of SOE directors, the interview directly addressed the question how directors think of bailouts. Many of them responded that they would not support the idea of bailouts in case of continuous loss-making (see Table 27). Some of them added a couple of conditions such as “if it not the fault of director, the state can support” (Firm K). There was, however, one director said ‘yes’ for bailouts but his argument was in the same context to others. He argued that

Many projects of this company are funded by the state budget but the reimbursement is made very slowly. Therefore the company has to rely on bank loans and pays interest. As a result, the projects bring about low efficiency and no profit. *In that case* the state budget must be mobilised to cover up the loss for the firm (emphasis added; quote from an equitised local SOE, Firm G).

Combining these responses with the perception of SOE directors on the assets of the SOE, we may draw a conclusion with caution that the hard resource constraints in the state budget have effectively changed the expectations of directors of SOEs. They do expect that financial support from the state budget will be limited. It appears that there has been a notable change in the expectations of SOE directors which is supposed to be the hardest part to change in the issue of soft budget constraints. In contrast to the conventional claim, the budget constraints on SOEs have become ‘harder’.

6.5. Concluding remarks: soft for big and hard for small SOEs

The analysis of the interview suggests us a couple of preliminary conclusions in terms of the softness of budget constraints on SOEs. Firstly, contrary to the conventional claim, there is evidence to show that the budget constraints on SOEs in Hai Phong have hardened. The expectation of being bailed out among SOE directors were low and the support from the state and local budget has dramatically decreased. The lack of state budget allocation deteriorates the operation of local SOEs resulted from the delayed public investment expenditure. Furthermore, the state divests of the assets of loss-making SOEs and allocates them to well-performing SOEs to increase the capital size of them. This is how the Vietnamese state has reduced the number of SOEs but been able to maintain the dominance of the state sector – *divestiture plus concentration*.

Secondly, there is evidence that large SOEs face softer budget constraints than small SOEs do. Centrally-managed SOEs which are large in terms of the number of labourers and the size of capital have better access to bank loans with the support of their powerful controlling organs such as General Corporations and SEGs compared to locally-managed SOEs whose controlling organs are local government departments and local People's Committee if they are equitised. There were informal modifications of the formal rules guiding access to bank loans. The formal rules required SOEs to put up collateral when they took out loans, but in fact, some SOEs received favoured treatment from banks because they were granted loans based on their 'reputation' without having to put up collateral. Furthermore, there appeared to be various interpretations of reputation and one dimension of reputation is likely to depend on the level of the state organs governing the firm. The higher the level of the governing organ the greater the SOE appeared to score on this aspect of reputation.

Two preliminary conclusions suggest that the budget constraints on SOEs in Hai Phong tend to have been hardened during the last decade. At the same time some large SOEs have faced *relatively* soft budget constraints. The conventional claim that SOEs operate with soft budget constraints could be simple generalisation made from the observation of macroeconomic data and mass media coverage. We, however, have to explain why some SOEs especially large centrally-managed SOEs have faces softer budget constraints.

A telling argument is that the connections which an SOE director has established largely affect the softness of budget constraints (Gainsborough 2005, Malesky and Taussig 2009, Tenev *et al.* 2003). From this viewpoint, reputation we mentioned above could mean something different in some cases. For large central SOEs, reputation was an assessment that the enterprise had adequate political backing and would be able to honour its obligations even if the economic operations turned out to be flawed. Thus, reputation could also be a metaphor for the level of informal connections of an enterprise, and a

well-connected firm found it easier to access bank loans. SOE directors have a very strong motive to put their effort into managing their connections. Nonetheless, this did not mean that there were no limits to the application of this informal rule. The reputation of the firms also needed to be maintained by repaying loans on schedule. The structure as a whole, therefore, created implicit soft budget constraints for well-connected large SOEs, particularly those with strong connections at the centre.

The obligation of SOEs to repay bank loans and to contribute to the state budget to maintain their reputation and consequent connections and political backing may explain why SOEs have diversified into non-related business areas which are likely to create quick cash flows. As Fforde (2007) argues the role of SOEs as a firm tax base caused the recentralisation through which the state tries to increase its influence over SOEs. This decreased the autonomy of SOEs but it does not mean that the state effectively increase its controlling power over SOEs. The outcome of this attempted recentralisation is ‘tax paying SOEs without being supervised’. A central SOE director (Firm R) said explicitly that “as long as our firm accomplished the goal of making profits and paying the tax payment, it does not matter how this is achieved”. A firm specialising in transportation could therefore easily diversify into the real-estate business to make quick profits.

The fact that enterprise directors diversified the activities of their firms and often diversified into risky activities suggests they had incentives for doing so in terms of informal benefits that managers, directors and their contacts in the political and administrative structure could access. The combination of formal and informal practices and arrangements, therefore, created private stakes in public enterprises.

It is not impossible that enterprises could seek profits through activities that were new and outside their areas of competence, through speculative investments and sometimes even by subverting the law. Obviously, in new areas where it does not have core

competences the risks are also much greater, and in some speculative and grey areas of activity (like betting on stock prices, exchange rates and so on), the risks can be very considerable. Our respondents would not tell us about the possible sharing of benefits between enterprise directors and the political and bureaucratic elites their firms were closely interacting with at the local or national level. However, the close collusion of supervisors, the regulatory apparatus of the state and the enterprise suggests that the principal-agent problem was not between the state and supervisors as principals and the enterprise as agent, but rather between the collective national state as principal and a closely colluding group of enterprise directors, state officials and supervisors as agents.

A significant problem of the system was that the collusion amongst state and enterprise players at the appropriate level meant that productive dynamism became difficult to distinguish from asset stripping behaviour or corruption. The colluding group could benefit from this behaviour because while they were residual claimants for the profits from such activity, they did not face the full costs of the downside of risky or illegal activities, in much the same way as some financial institutions in Western countries before the global financial crisis of 2008.

While the connections among SOEs director, politician and bankers play an important role in deciding the softness of budget constraints provides insightful analysis, this dissertation raises a question whether the connection is a necessary and sufficient condition of soft budget constraints for an SOE. To get political backing, having connections is a necessary condition but may not be sufficient and what is required is a political decision regarding whether this SOE deserves to be selected for survival or not. Provided that the political gains of the state are smaller than its financial spending, it is unlikely that the state helps the SOE in difficulty.

For example, the National Assembly of Vietnam approved the allocation of VND 5 trillion (equivalent to USD 250 million) from the state budget to five large SOEs in December 2010. They were the Vietnam National Oil and Gas Group (PetroVietnam), the Electricity of Vietnam Group (EVN), the Vietnam Railway Corporation (VRC), the Vietnam Post and Telecommunication Group (VNPT) and Vietnam National Shipping Lines (Vinalines).

This example is interesting because direct fiscal support was provided to five big businesses and also it was probably a disguised bailout programme for a bankrupt SEG, the Vietnam Shipbuilding Industry Group (Vinashin), with USD 4.4 billion of debt in June 2010. Vinashin, according to its restructuring programme, was divided into three parts which would respectively be under the management of PetroVietnam, Vinalines and Vinashin itself whose name was changed later into the Shipbuilding Industry Corporation (SBIC).

Coincidentally, PetroVietnam, ranked in the top five largest SOEs and unlikely to make a loss, was allocated VND 3,500 billion (equivalent to USD 175 million) without publicising the list of projects which the state funds were to be used for. In addition, Vinalines, currently ranked in the top 100 largest firms, was included in the list of firms receiving support from the state budget. Although there is no clear evidence that the state bailed out Vinashin, it was probably no accident that the two companies which were to take over parts of the collapsed Vinashin were included in this state budget support programme whose objective was not clearly announced.

This experience suggests that the ‘too big to fail’ criterion comes into play due to both political and economic reason so that budget constraints may be hard for small SOEs but may not be for large SOEs. We could find that few centrally-managed director has the belief that the state would help them in the last resort because they are SOEs and big. An

SOE director answered to the question “does your company have any advantages in comparison with a JSC?” as follow:

There are many advantages of being a state-owned company. The state gives us priority and creates better conditions for our business. Ultimately the state has to take care of us and this is *just like subsidisation* (quoted from a central SOE, R; emphasis added).

Finally, SOEs are criticised because of their inefficiency. Macroeconomic data indicate that the SOEs consume too much resources compared to their outputs. Nonetheless, the data we examined in Chapter 4 show that the proportion of profit-making SOEs is over 70 per cent while some of loss-making SOEs make large amount of loss. As Matheson (2013: 9) shows SOEs show a wide range of profitability. For example, returns on equity for 95 largest SOEs in 2010 varied from less than zero to more than 25. EVN and Waterway Construction fell to the first category and Viettel, Vinacomin, HUD belonged to the second category. We found that many of SOEs pointed out ‘own equity’ as one of main sources of investment and own equity as we examined can be defined as turnover minus costs in which tax contribution, all variable and fixed costs and obligatory funds are include. This implies that the interviewed SOEs were in fact making enough profits so that they rely on their own sources instead of external sources such as bank loans and aid.

7. Conclusion

The main aim of this dissertation is to revise the conventional claim that SOEs face soft budget constraints based on the examination of banking sector data. There, however, are a limited amount of studies on the topic of soft budget constraints on SOE. What existing studies point out as evidence of soft budget constraints on SOEs is easier access to bank loans but the key aspect of the soft budget constraint syndrome is the formation of expectations of being bailed out by the state among SOE directors. None of existing studies directly addresses this issue except Gainsborough (2005). Furthermore the focus of analyses is not SOEs but private firms so that the data set of some insightful firm-level analyses such as Tenev *et al.* (2003) and Gainsborough (*ibid.*) include both private firms and SOEs and that of Malesky and Taussig (2009) contains private firms only.

To fill this gap, this dissertation conducted interviews with twenty two centrally-managed, locally-managed and equitised SOEs which operated in Hai Phong in 2005 by supplementing the method used in Gainsborough (2005) whose data set is composed of twenty-four private firms and SOEs from four provinces. Also our interviews directly address the issue of expectations of being bailed out among SOE directors. While the sample size is our data set is not big, this does not harm the consistency of our findings. The analysis of the interviews produces similar outcomes of Gainsborough (*ibid.*) and Tenev *et al.* (*ibid.*) in various respects.

One of our notable findings is that the budget constraints on SOEs in Hai Phong has been hardened since the late 1990s and within this trend some large centrally-managed SOEs have faced relatively soft budget constraints. One of interviewees from the Department of Finance of Hai Phong told us that the state implemented divestiture of the assets of loss-making SOEs and allocated capital to profit-making SOEs to increase their capital size. So the state enforced a mixed policy to reduce the number of SOEs but also make

leftovers bigger – *divestiture plus concentration*. Table 18 (p. 151) confirms this pattern. The number of centrally-managed SOEs reduced by 13 per cent between 2000 and 2012, while that of locally-managed SOEs reduced by 60 per cent over the same period. Cheshier *et al.* (2006: 6) describe this as ‘keeping the big and releasing the small’ and General Corporations and State Economic Groups are the result of this move (also see Table 20, Table 21 and Table 22 of this dissertation).

However, it appears that hardening the budget constraint on large SOEs has not been successful. The access to bank loans is significantly affected by the ‘reputation’ of SOEs which is the result of long-term relationship between banks and SOEs. What we find is that centrally-managed SOEs have better reputation than locally-managed SOEs do. This can be explained by extending the telling argument of Gainsborough (*ibid.*) that the connections which firm managers have with politicians and banker largely determine the softness of budget constraints regardless of ownership type of a firm. The controlling organs of centrally-managed SOEs we interviewed are either ministers or General Corporations whose General Director reports directly to the Prime Minister while those of locally-managed SOEs we interviewed are department heads. It is not difficult to conjecture that the political backing of centrally-managed SOEs in general is stronger than that of locally-managed SOEs.

The degree of political backing directly affects the expectation of being bailed out among SOE directors. Many of SOEs directors answered that the director of loss-making SOE has to take responsibility for the loss occurred but a couple of centrally-managed SOE directors answer that the state will help them at last. From this fact, we can develop two theories. One is that SOE director are likely to put their efforts in managing connections and the other one is that while the connections which the SOE director has established play an important role in determining the softness of budget constraints but this is not a sufficient condition of soft budget constraints.

If an SOE director knows that the state will bail out the firm in case of making a loss, the director is not likely to spend his/her time to improve the performance of firm. Instead s/he puts more effort in managing connections to maximise the likelihood of getting help from politicians when the firm performs badly. Furthermore, if this firm has monopoly power, the director is less likely to put effort in managing the firm. The business area of the director quoted above is waterway dredging which has monopoly power in the domestic market. On the other hand, if the director knows that the state will not bail out the firm, s/he puts more effort in managing the firm. One more condition we have to consider is that the salary of SOEs directors is very low. This suggests that the opportunity costs of losing his/her position is not large enough to deter the director from shirking. Consequently, the rational behaviour of SOE directors is establishing and managing connections, which is likely to bring him/her unofficial revenues.

However, having connections is not sufficient to bring soft budget constraints. A factor we have not considered is that the state will determine whether to allow financial support or not. In what circumstance, is the state likely to offer financial support to SOEs in difficulty? In case of bailouts, the state will bear financial loss but it also will have political benefit. A commonly known gain is that the state can maintain people's trust in it by bailing out the firm which hires a large amount of workers or keeping the firm in strategic areas which are not profitable but essential to national interests.

In the context of Vietnam, the state seeks to keep the leading role of the state sector in society, which is closely related to the legitimacy of the CPV as well. Leaving SOEs in difficulty without helping is not compatible with this political goal. However, the state cannot keep helping SOEs in difficulty because it keeps accumulating budget deficits. Therefore the rational choice of the state is to help selected SOEs which have substantial impact on the economy. Consequently, large SOEs are likely to be chosen for being

offered financial support. Hence, the findings that large SOEs faced softer budget constraints compared to small SOE did in Hai Phong, and a couple of large SOE directors replied that they believed the state would help them at last are the outcome of a rational choice of the state and SOE directors. Without referring to individual connections among SOE directors, politicians and bankers, we are able to broadly explain a pattern of budget constraints on different group of SOEs.

On the other hand, this dissertation considers the budget constraints on SOEs as a proxy of state-business relations. There a number of different types of state-business relations are widely acknowledged in the field of political economy¹⁶⁹: authoritative, predatory, developmental,¹⁷⁰ entrepreneurial¹⁷¹ and clientelist¹⁷² relations. These originate mainly in

¹⁶⁹ Baum and Shevchenko (1999) classify political systems into four sorts according to the ties between politics and businesses: developmental, predatory, clientelist and entrepreneurial. Krueger (1993) categorised political systems into benevolent, authoritative and predatory system according to the nature of individuals who composed of the government and politics.

¹⁷⁰ Developmental relationships between government and business were observed during the industrialisation of Japan, South Korea and Taiwan where economic growth was achieved mainly through the extensive use of industrial policies such as intensive investment plans in several core industries, export drive with strong negative and positive incentives to related firms, forced saving policies, tight control over financial markets and effective acquisition of advanced technologies (Amsden 1989, Aoki *et al.* 1998, Chang 1994, Evans 1992, 1995, 1997, Johnson 1982, Wade 1990, White 1988). Some studies argue that Vietnam has a feature of the developmental state while it has a relatively weak enforcement (Abuza 1998, Esterline 1988, Kolko 1997, Porter 1993).

¹⁷¹ Entrepreneurial relationships between business and government have mainly been observed over the course of economic growth in local Chinese governments (Blecher 1991, Duckett 1998, Nee 1992, Oi and Walder 1999, Rodrik 2007). The main feature of entrepreneurial relationships is that politicians are directly engaged in business activities. For example, local governments set up firms related to state functions and doing business in ways adapted to the changes in political and socio-economic conditions that allowed a growing non-state sector to engage in economic activities. Staffs of the firms were normally composed of retired or departing workers from related government departments and the profits of the firms were shared with the relevant departments. Therefore, the business activities of the firms established by local departments were directly related to local economic development.

¹⁷² Clientelist relations are frequently referred to as 'patron-client' relationships between government and society, including business organisations. The model explains why a bureaucrat's authority is likely to depend more on his personal following and extra-

studies of the economic growth in East Asian and South East Asian countries because the path of economic growth in this region was quite different from that observed in advanced Anglo-American developed economies based on rule-based relationships between business and government.¹⁷³

When the political leadership or ruling coalition organisations have effective enforcement capabilities, dense ties with the business community can lead to a developmental relationship. A developmental state has effective state and political organisations that can impose discipline on lower-level members of these organisations; when the political leadership is dominated by individual profit maximisers, the same dense ties can result in a clientelist state or even predatory one.

Assessing state-business relations in terms of budget constraints is not a usual approach. This dissertation addresses this question by considering whether the *state uses SOEs in seeking its specific political goal* as compares the case of Malaysia and Singapore with that of Vietnam which share common features such as the dominance of the state sector and murky distinction between the public and the private sector.

bureaucratic connections than on his formal post (Scott 1972). The essence of clientelist relations is the exchange of resources based on asymmetric power and dependence between patrons and clients. They are observed in many developing countries including South East Asian countries – Indonesia, Malaysia and Thailand (Doner and Ramsay 1997, Eisenstadt and Roniger 1980, Khan 2005, 2010) – and also both in China (Pearson 1997, Ruf 1999, Wank 1995) and Vietnam (Fforde 2002, Herno 1998, Vasavakul 1999, 2003). The political centre in Vietnam is not strong enough to suppress the evolution of clientelist relations (Fforde 2010, Fforde 2011, 2013).

¹⁷³ Chang (2002) effectively argued that the Anglo-American developed economies used to have modes of development which were not based on free market mechanism but based on widespread intervention of the politics via industrial policies. Consequently, it is unfair for now developing countries to be forced by developed countries to follow modern economic orders represented by the Washington Consensus. The author agrees to this argument but the historical background of developed economies is not the main focus of the thesis whose aim is to compare the currently dominant political system of developed countries to that of developing countries.

We examined that a political priority is given to keep the leading role of the state sector in Vietnam and the state cannot let SOEs die. Hence it has to support some selected SOEs in difficulty due to its own budget constraint. Consequently, some large SOEs face softer budget constraints. In Malaysia, strengthening Bumiputras economic share is a top political priority. Privatisation and running GLCs have largely been affected by this political goal which made the state choose wrong incompetent partners as private Bumiputra shareholders and the state had to support poorly managed privatisation projects and bad performing GLCs to maintain Bumiputras' capital share. The state-business relations in Malaysia and Vietnam might hamper economic growth.

In Singapore, in contrast to the case of Vietnam and Malaysia, the state sector and GLCs work efficiently given its large state sector and blurred distinction between the state and the private sector. Not least it is presumed that holding multiple positions in both private and public organisations is likely to cause conflicts of interest and result in corruption but this presumption has been proved wrong in Singapore in which the state has deployed GLCs based on a profit-making goal only, not even the generation of employment in a growth-enhancing way. Nonetheless, it is not clearly explained why the murky border between the private and the public sector has not resulted in conflicts of interest which is likely to hamper economic growth.

Can this approach supplement the existing taxonomy of state-business relations? It is widely acknowledged that developmental connections enhance economic growth while clientelist connections hamper it. However, not all developmental connections can be growth-enhancing.¹⁷⁴ For example, the state is supposed to be rather independent for the

¹⁷⁴ Some clientelist connections, however, could enhance economic growth. An economy dominated by patron-client relations is unlikely to have a coherent state as a ruling organ (Khan 2005). Hence, the patron allocates resources to the clients. There can be various types of patrons and clients. Some patrons can be predatory and others can be developmental, and some clients can be rent-seeker and others can be productive business entities. According

interests of businesses and firms are likely to face hard budget constraints. At the same time, the developmental state runs trade and industrial policy to improve the country's competitiveness. Hence a firm operates in strategic sectors is likely to have softer budget constraints because the state would provide policy financing. If the state pursues purely an economic goal, there will be a strict application of the 'carrot and stick' rule. In that case, firm managers expect that the policy financing provided will be revoked sooner or later depending on their performance and they will have to bear the responsibility for loss. The strict application of the rule can be deterred not only *ex post* but also *ex ante* if the state seeks other goals.

Limits of this study and further research

The data set of this dissertation has three limitations. It was collected in 2005, from twenty-two SOEs, in one location. The data can be outdated and may have failed to reflect some variations which can be found in other provinces and other SOEs. The findings of this dissertation, however, are not significantly different from Tenev *et al.* (2003), Gainsborough (2005) and Malesky and Taussig (2009) in which the data were collected from many firms in various locations. Nonetheless, generalisation of preliminary findings in this dissertation should cautiously be made and further supplementary works are required by extending the sample size across various locations. Furthermore, as Gainsborough (2005) argues individual connections of SOE directors with politician and bankers is important in determining the softness of budget constraints on SOEs. The dissertation can be augmented largely if data set includes bankers particularly from SOCBs.

to Doner and Ramsay (1997) and (Khan 2010), Thailand's political economy in the 1980s and 1990s during its high growth was a typical example of patron-client relationships generating high levels of economic development. Here the alliances between patrons in the state and client entrepreneurs resulted in high rates of growth because entrepreneurs got access to resources for investment and competition between patron-client networks ensured that enterprises kept investing in a competitive export-oriented market economy.

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Appendix

Table A1: The list of GC-91 and SEGs

GC-91	Name
1	Housing and Urban Development Corporation
2	Song Da Corporation (Construction and power)
3	Vietnam Northern Food Corporation
4	Vietnam Southern Food Corporation
5	Vietnam Paper Corporation
6	Vietnam National Coffee Corporation
7	Vietnam Airlines Corporation
8	Vietnam National Tobacco Corporation
9	Vietnam National Shipping Lines
10	Vietnam Railways
11	Vietnam Steel Corporation
12	Vietnam Cement Industry Corporation
SEGs	Name
1	Vietnam Posts and Telecommunications Group (VNPT)
2	Vietnam National Coal – Mineral Industries Holding Corporation Limited (VINACOMIN)
3	Vietnam Oil and Gas Group
4	Vietnam Electricity
5	The Vietnam National Textile and Garment Group
6	Vietnam Rubber Group
7	BaoViet Holdings (Insurance)
8	Viettel Group (Telecommunication)
9	Vietnam National Chemical Group
10	Vietnam National Petroleum Group

Table A2: Criteria of small, medium and large enterprises in Vietnam

		Agriculture, forestry and fishery	Industry and construction	Trade and services
Micro enterprises	Capital	Not defined	Not defined	Not defined
	Employees	≤ 10	≤ 10	≤ 10
Small enterprises	Capital (billion VND)	≤ 20	≤ 20	≤ 10
	Employees	$10 < L \leq 200$	$10 < L \leq 200$	$10 < L \leq 50$
Medium enterprises	Capital (billion VND)	$20 < K \leq 100$	$20 < K \leq 100$	$10 < K \leq 50$
	Employees	$200 < L \leq 300$	$200 < L \leq 300$	$50 < L \leq 100$
Large enterprises	Capital (billion VND)	$K > 100$	$K > 100$	$K > 50$
	Employees	$L > 300$	$L > 300$	$L > 100$

Source: General Statistics Office of Vietnam (2009: 33). The criteria follow Decree No. 56/2009/ND-CP dated 30 June 2009.

Table A3: Proportion of gainers and loser (2000-2002, 2005-2011, per cent)

Year	Economy		State		Non-state		Foreign-invested	
	Gainers	Losers	Gainers	Losers	Gainers	Losers	Gainers	Losers
2000	78.3	19.39	78.82	17.45	79.75	18.2	43.02	54.03
2001	72.8	19.76	79.35	16.69	73.55	18.77	38.94	49.88
2002	75.14	21.03	82.96	14.67	75.57	20.44	46.53	49.83
2005	62.53	27.38	79.59	17.16	62.36	27.06	48.66	47.96
2006	65.65	31.12	82.37	14.33	65.71	31.05	49.45	47.73
2007	67.56	29.66	85.52	12.18	67.69	29.49	51.24	46.62
2008	69.37	27.7	85.67	12.73	69.76	27.25	47.17	51.19
2009	61.86	26.5	85.86	12.23	61.85	26.03	49.83	49.83
2010	64.12	25.14	84.61	13.65	64.13	24.67	54.28	44.32
2011	53.93	42.88	80.8	17.37	53.65	43.09	53.82	44.97

Sources:

1. General Statistics Office of Vietnam (2013), *Development of Vietnam Enterprises in the Period of 2006-2011*. Hanoi: Statistics Publishing House.
2. General Statistics Office of Vietnam (2009), *The Situation of Enterprises through the Results of Surveys Conducted in 2006, 2007, 2008*. Hanoi: Statistics Publishing House.
3. General Statistics Office of Vietnam (2004), *Industrial Complete Survey 2001-2003*. Hanoi: Statistics Publishing House.

Table A4: Understanding of ‘own equity’ by SOE directors in Hai Phong

Firm	Answer
A	n.a.
B	The fund mobilised by the firm from various resources – not the fund supply from the state resources.
C	The fund that the SOE has by accumulating income from production selling products after deducting the required taxes to be paid.
D	n.a.
E	n.a.
F	n.a.
G	The fund accumulated from results of production and business generated by the firm.
H	The fund of the firm accumulated from the retained profits.
I	The accumulated fund from the annual profit to be used for procurement of equipment and machines for re-investment.
J	The fund of the firm generated by the enterprises from its own profits.
K	n.a.
L	The fund established from profitable business run by the firm.
M	The fund established from production and business and from the non-refundable grants.
N	The capital generated by the firm from profit.
O	The capital formulated from the retained profit.
P	The capital retained from profit after tax.
Q	In accordance with the state regulation, the “self-generated capital” is created by the enterprise from the result of production and business every year.
R	The money accumulated from profit after tax (Fund for Production Development)
S	The ‘self-generated capital’ is owned by the firm (supplied by the state; fund accumulated during the production and business).
T	The fund obtained from the firm business activities.
U	n.a.

Table A5: Questionnaire for an SOE

QUESTIONNAIRE FOR THE SURVEY OF SOEs IN TP. HAI PHONG

DATE OF INTERVIEW:

Explain the nature of the research, emphasise that nothing the person says will be directly attributable either to them or their company. Please attach their business card the final report.

Name of firm

- 1) Vietnamese:
- 2) English:

A. COMPANY ACTIVITY

- 1 When was the firm founded?
- 2 Who is the firm's controlling institution(s)?
- 3 Has this changed in the last 10 years? If there were any changes, please specify.
- 4 What is this company's primary product or activity?
- 5 Has this changed in the last 10 years? Describe.
- 6 Does the firm have any shareholdings in other firms or banks? If yes, are they subsidiary firms/banks?
- 7 Describe the share of capital (% of total) of the firm:
 - a) State budget (central / local):
 - b) Loan:
 - c) Own capital:

- 8 How many people does the firm employ?
- 9 What is the annual turnover of the firm?
- 10 What is the annual investment of the firm?

B. DIFFICULTIES / OPPORTUNITIES IN RUNNING THE BUSINESS

- 11 What are the most severe obstacles to your business (encourage interviewee to provide at least three)?
 - 1)
 - 2)
 - 3)
- 12 What important changes in the business environment have positively impacted the running of the firm over the last 3-5 years?
 - 1)
 - 2)
 - 3)

C. ADMINISTRATIVE SUPPORT / REGULATION

- 13 Describe your interaction with local government.
- 14 Has this interaction changed over the last 5 years?

- 15 Are there any production plans (industry, sector, and/or firm specific) that the firm is required to follow? Please describe, including who formulates and disseminates the plan(s).
- 16 If yes, what mechanisms (investment approval, allocation of state budget capital, etc.) are used to ensure the firm follows the plans?
- 17 Does government provide any tax incentives, such as tax reductions and/or exemptions? Please describe, including for what purposes the incentives are given.
- 18 Does government provide market research or other information to assist in finding buyers for the firm's products? Describe.
- 19 Does government restrict and/or facilitate movement into new product lines or changes of business? Describe, including the incentives used.
- 20 Is government involved in determining staffing levels? Describe.

21 Does government provide job training or retraining for employees? Describe.

D. FINANCE

22 In what areas has the firm invested over the last 3-5 years?

23 When was the last time the firm invested in new capital equipment?

24 If land was acquired in the last 5 years:

- a) How was it financed?
- b) Who made the decision?
- c) How much did it cost?
- d) What was done with the land?
- e) Who was the land acquired from?

25 What have been the sources of investment capital over the last 3-5 years (pick as many as apply and what is the most important source)?

- | | |
|--------------------------------|-------------------------------------|
| 0. State budget central | 1. State budget local |
| 2. State-owned commercial bank | 3. Joint stock bank |
| 4. Foreign bank | 5. Domestic investors |
| 6. FDI | 7. Own equity |
| 8. Investment Development Fund | 9. Capital mobilised from employees |
| 10. Sale of state houses | 11. Other: |

26 How do you understand the term 'own equity'?

- 27 Describe the process of applying for bank credit and who actually gives final approval for the application.
- 28 Has the application process and/or terms of loans (collateral, favoured interest rates, etc.) changed in the last 5 years? If so, how?
- 29 Are the processes and/or terms of loans different for long term and short term loans? If so, how?
- 30 Please list the last 5 major investments by the firm. Describe the selection process, rationale, and the role of the controlling institution in each decision.
- a)
 - b)
 - c)
 - d)
 - e)

- 31 Has access to capital from the state budget become harder to secure in comparison with the last 5-10 years and 3-5 years? Please describe.

E. DECISION MAKING PROCESS

- 32 Describe any obstacles you face in carrying out your role in the firm.
- 33 Describe the use of the following enterprise funds:
- a) Financial Reserve Fund
 - How much:
 - What purposes:
 - Who decides:
 - b) Welfare Fund
 - How much:
 - What purposes:
 - Who decides:
 - c) Reward Fund
 - How much:
 - What purposes:
 - Who decides:
 - d) Has it been paid to any individuals or units outside the firm? If yes, to whom and why?
 - Who decides:
- 34 If the firm makes a loss, who is responsible and how is the loss financed?

35 Do you think the state budget should be mobilised to cover losses?

36 How do you resolve confusions and disagreement with the controlling institution(s)? Please describe the process and the role of the controlling institution(s).

37 Which outside institutions do you refer to in making decisions on the following issues (if applicable)?

0. Personnel issues (fire and hire)

1. Increasing/decreasing and ceasing production

2. Increasing investment

3. Selling assets, plant or equipment

4. Decisions to raise wage

5. Decisions to pay bonuses

F. DIRECTOR / ENTREPRENEUR

38 What is your place and date of birth?

39 Give a brief outline of your career (including education, wartime, and at other SOEs).

END

Table A6: Questionnaire for a government officer

THE QUESTIONNAIRE FOR LOCAL OFFICIALS IN TP. HAI PHONG

DATE OF INTERVIEW:

Explain the nature of the research, emphasise that nothing the person says will be directly attributable either to them or their company. Please attach interviewee's business card the final report.

A. ADMINISTRATIVE ROLE IN RELATION TO FIRMS

- 1 What is your position?
- 2 Please describe your duties.
- 3 Describe the role of your department and its relation to SOEs.
- 4 Do you or anyone else in your department sit on the management board of any SOEs? If yes, which ones?
- 5 What is your role in supporting the management of SOEs?
- 6 Describe your day to day interaction with SOEs.

- 7 Describe the types of decisions that you refer to higher authorities.
- 8 Describe the types of decisions that SOEs can take on their own without your involvement.
- 9 Are you or your department involved in determining product lines of SOEs? Describe.
- 10 Are you or your department involved in the financing decisions of SOEs? Describe your role.
- 11 Are you or your department involved in developing investment plans? If yes, please describe.
- 12 Are you or your department involved in the identification of buyers and sellers for SOEs?
Describe.
- 13 Are you or your department involved in determining staffing levels and/or recruiting for SOEs?
Describe.
- 14 Do you or your department provide training for SOE employees? Describe.

- 15 Have any of these roles changed in the last 5 years? Describe.
- 16 How do you resolve confusions and disagreements with SOEs? Please give examples.
- 17 Are there production plans (industry, sector, and/or firm specific) that you or your department are tasked with implementing? Describe.
- 18 If yes, who formulates them and what is the formulation process?
- 19 If yes, has the process changed in the last 5 years? Describe.
- 20 If yes, how are the plans implemented? (state budget, bank credit, etc.)
- 21 If yes, has the ability to implement the plan(s) changed in the last 5 years? If yes, how?
- 22 How do you evaluate the performance of SOEs?

- 23 What do you do if SOEs are not performing well?
- 24 Does your department provide market research or other information to SOEs to assist in finding buyers for the firms' products? Describe.
- 25 Has the process whereby SOEs access state and/or local budget capital changed in the last 5 years? Describe.
- 26 Has the process whereby SOEs obtain bank loans changed in the last 5 years? Describe.
- 27 How do you think the business environment has changed over the last 3-5 years?
(encourage the interviewee to provide at least three responses)
- 1)
 - 2)
 - 3)
- 28 How has the 2002 State Budget Law changed your role and the role of local authorities?
- 29 How has TP. Hai Phong secured own-source revenue? What types of revenue has the City secured?

B. PERSONAL BACKGROUND

- 30 What is your place and date of birth?
- 31 What is the highest level of education you have completed?
- 32 Have you had the opportunity to go abroad for study or training? If yes, how many times and how long?
- 33 Give a brief outline of your career.
- 34 How long have you worked in this position?
- 35 Are you a member of the Vietnamese Communist Party (if yes, how many years)?
- 36 What did / do your parents do? If you are married, what does your spouse do?

END